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Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

VALICENTI ADVISORY SERVICES, INC.
and VINCENT R. VALICENTI,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

DID THE COURT OF APPEALS ERR BY AFFIRMING THE DECISION OF THE SECURITIES AND EXCHANGE COMMISSION ("COMMISSION") AS BEING SUPPORTED BY SUBSTANTIAL EVIDENCE WITHOUT CONSIDERING THE CONTRARY FACTUAL FINDINGS OF THE ADMINISTRATIVE LAW JUDGE ON ISSUES OF CREDIBILITY?

LIST OF PARTIES

All parties to the proceeding before the Second Circuit are listed in the caption. Valicenti Advisory Services, Inc. has no parent or subsidiary corporations. See S.Ct. Rule 29.6.

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OPINIONS BELOW

The (amended) opinion of the United States Court of Appeals for the Second Circuit in Valicenti Advisory Services, Inc. v. Securities and Exchange Commission, 198 F.3d 62 (2d Cir. 1999), is set forth in the Appendix hereto (App. A-1).

The opinion of the Securities and Exchange Commission in In re Valicenti Advisory Services, Inc. 68 S.E.C. Docket 1762, 1998 WESTLAW 798699 (November 18, 1998), is set forth in the Appendix hereto (App. A-12).

The opinion of the administrative law judge in In re Valicenti Advisory Services, Inc., 64 S.E.C. Docket 2281, 1997 WESTLAW 362000 (July 2, 1997), is set forth in the Appendix hereto (App. A-21).

BASIS FOR JURISDICTION

The order of the United States Court of Appeals for the Second Circuit denying petitioners' petition for rehearing and rehearing en banc was entered on February 24, 2000 (App. A-64). This petition for writ of certiorari is filed within ninety (90) days from that date. 28 U.S.C. Section 2101 (c); Sup. Ct. Rule 13(1), (3).

The jurisdiction of this Court is invoked pursuant to the provisions of 28 U.S.C. Section 1254.

STATUTE INVOLVED

15 U.S.C. Section 80b-6. Prohibited Transactions by Investment Advisers

> It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly –
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client; * * * *

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4), by rules and regulations define, and prescribe means reasonably designed to prevent such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

STATEMENT OF THE CASE

This case arises out of a formal administrative proceeding commenced by the Securities and Exchange Commission which charged that petitioners had violated the antifraud provisions of the Investment Advisers Act of 1940 ("Advisers Act"), 15 U.S.C. Section 80b-1, et seq., by creating and distributing, among other things, a chart ("Chart") and a graph ("Graph") depicting past performance of certain accounts from 1987 to 1991 (App. A-25). After holding a hearing covering five days, the Administrative Law Judge ("ALJ") issued a decision holding that petitioner Valicenti Advisory Services, Inc. ("VAS") negligently violated Section 206(2) & (4) of the Advisers Act and censuring VAS (App. A-63). Upon review, the Commission reversed the ALJ's decision and found that both petitioners had violated Section 206(1), (2) & (4) and had acted with an intent to defraud prospective clients of VAS in creating the Chart and Graph. In addition to imposing a censure, cease and desist order and significant monetary penalties, the Commission took the unprecedented step of requiring petitioners to distribute a copy of the Commission's strongly-worded opinion and order to all of VAS's existing clients, no matter how longstanding, by certified mail, return receipt requested, and to every prospective client for a period of one year. (App. A-22-3). The Second Circuit affirmed the Commission's decision in all respects and petitioners' petition for rehearing en banc was denied.

The Chart (which was distributed on a very limited basis in 1992) described the accounts reflected therein as "a composite of

discretionary accounts with a balanced objective" (App. A-34). The Commission concluded that petitioners intended to mislead prospective clients to believe that the chart included the performance of all VAS balanced accounts in existence for five years. The Commission further concluded that petitioners had used a small and distorted sample of accounts, included accounts that were not "balanced" accounts, and then tinkered with the results to produce inflated rates of return (App. A-20). Based upon its conclusions, the Commission reversed the ALJ's decision.

However, in a detailed opinion with numerous citations to testimony and exhibits, the ALJ had credited petitioner Valicenti's testimony and found that petitioners had not intended to defraud any prospective client in creating the Chart or Graph. The ALJ credited five critical aspects (set forth below) of petitioner Valicenti's testimony in finding that neither the terminology nor the selection of VAS accounts to be included in the Chart were the result of any intent to defraud prospective clients. Each of these findings were explicitly or implicitly rejected by the Commission. The Second Circuit opinion failed to even address the numerous conflicts between the findings of the ALJ and the Commission.

1. The ALJ credited Valicenti's testimony that "composite" as that term was used in the chart meant "selection." As the Commission acknowledged, this is consistent with the dictionary definition of that term (App. A-15). Nevertheless, the Commission found that the "plain meaning of that statement is that the rates reflect the performance of all accounts falling within the stated criteria[.]" (App. A-15). In concluding that petitioners had acted with scienter, the Commission relied extensively upon its finding that petitioners deliberately misrepresented to prospective clients that all of their discretionary accounts with a balanced investment objective

were included in the chart.[1] If Valicenti's unrefuted testimony on this point is properly credited (and "composite" meant "selection of accounts"), then the petitioners' use of the term "composite" provides no evidence of any intent to defraud.

2. The ALJ also credited Valicenti's testimony that an "account with a balanced objective" was defined by investment objective, rather than by asset allocation. (App. A-36). The Commission rejected that testimony and, in finding that petitioners acted with scienter, relied heavily upon the fact that some accounts fell outside of the expected asset allocation ranges for balanced accounts (referred to as the "70/30 criteria")[2] at the end of some years. (App. A-18). Again, if Valicenti's testimony on this point is properly credited, then the fact that some accounts fell outside of the 70/30 criteria at the end of some years provides no evidence of any intent to defraud.

3. The ALJ further credited Valicenti's testimony that, even if every account did not fall within the 70/30 criteria for each year, as a whole the accounts underlying the chart would certainly fall within the range. (App. A-35). The Commission rejected this testimony as being "clearly contrary to the Chart's representation that it reflected a composite of balanced accounts." (App. A-19). Of course, Valicenti's testimony does not conflict with the Chart's representation if his testimony

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[1] In support of its finding that petitioners intended to mislead prospective clients, the Commission also noted that many more accounts fell within the 70/30 guideline in a given year than were included on the Chart. (App. A-14). What the Commission failed to consider, however, is that only a small number of all VAS accounts (28) that were in existence from 1987-1991 fell within the 70/30 guideline at the end of all five years. The Commission's misunderstanding of this fact may also have had a material effect upon its decision not to credit Valicenti's testimony.

[2] Valicenti considered an account to be balanced if it had some mixture of stocks and bonds, not more than 70% of either, with some exceptions to the rule. He considered a 70%-30% split as a guideline, rather than a hard and fast rule. (App. A-36).

concerning the meaning of "composite" and "accounts with a balanced objective" is properly credited.

4. The ALJ credited Valicenti's testimony that, at the time the original 22 accounts were selected for inclusion in the chart, in January, 1992, he had no asset allocation or performance information concerning those accounts. (App. A-35). The ALJ also credited Valicenti's testimony justifying the later exclusion of three accounts to bring the total number of accounts reflected in the chart to 19. (App. A-38). Finally, the ALJ also credited Valicenti's testimony that no account had been included or excluded on the basis of performance. (App. A-35).

5. Despite the ALJ's finding that Valicenti "intended to have a composite that was representative of accounts under management" (App. A-36), the Commission found that Valicenti's failure to include accounts less than $100,000 in the Chart indicated that petitioners intended to defraud prospective clients (App. A-17).[3]

The Commission essentially rejected the ALJ's credibility determinations out of hand and concluded that petitioners had "tinkered with" performance results to improve those results. The Commission based it conclusion on the existence of a draft performance calculation, made four months after the original 22 accounts were selected, which reflected a slightly negative rate of return for 1987 (-.84%). (App. A-17). The Chart in its final form reflects a modest positive return for 1987 (2.6%). (App. A-18). According to the testimony credited by the ALJ, the reason for the change in performance for 1987 was attributable to the replacement of 3 ineligible accounts (which happened to have negative return in 1987) with 3 eligible accounts (which happened to have positive rates of return in 1987). (App. A-38). Each of these accounts was among the 22 originally selected by Valicenti – no new accounts were ever added.

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[3] Significantly, the issue of minimum account size was not even raised by the Commission's Division of Enforcement in its case in chief, and only discussed by an expert witness who was offered and received for rebuttal purposes only (App. A-44).

Since the Commission had already erroneously determined that petitioners had deliberately misrepresented the number of accounts and asset allocation composition in the chart, it wasted little time in rejected petitioners' testimony and concluding that the performance results had been fraudulently manipulated for 1987.

In imposing severe sanctions against petitioners, the Commission stated that it took a "less sanguine" view of the evidence than did the ALJ. (App. A-21). However, the Commission's viewpoint was founded upon the erroneous rejection of the ALJ's credibility determinations on key issues of fact. At the same time, the Commission failed to take into account other evidence credited by the ALJ which, when properly considered, supports the ALJ's credibility findings. The evidence overlooked by the Commission included the following: (1) Valicenti insisted on a lengthy and time consuming process, covering several months, for preparing the performance results (App. A-34). (2) Valicenti was able to explain in detail the reasons, unrelated to performance, that he included and excluded accounts from the Chart (App. A-35). (3) the Chart and Graph were placed in the back of VAS' (blue) marketing folder, behind numerous other inserts (App. A-32). (4) the blue folder was distributed only in "very limited situations" (App. A-59). (5) petitioners described the performance in the Chart to some prospective clients as being "based upon a sampling of portfolios which are discretionary" (App. A-6). Finally, (6) petitioners were concerned enough about the accuracy of a later Chart (depicting 1988-1992 performance) to decide not to distribute those materials (App. A-59).

Beginning with a cynicism which was premised upon its erroneous rejection of Valicenti's testimony, the Commission proceeded to view every perceived problem with the performance materials as being the result of an intent to defraud — rejecting the ALJ's findings that the petitioners acted in good faith (albeit negligently).

Upon review, the Second Circuit failed to even mention the ALJ's initial decision. Indeed, the Second Circuit reviewed the

Commission's decision as if the ALJ had not even rendered a decision, let alone a decision which found that petitioners had acted in good faith in creating the performance materials. Valicenti Advisory Services, Inc. v. SEC, 198 F.3d 62, 65 (2d Cir. 1999). The Second Circuit's decision did not address the crucial difference between the Commission's finding of a violation under Section 206(2) & (4) of the Advisers Act, 15 U.S.C. Section 80b-6(2) & (4), which require only that petitioners have acted negligently, and the Commission's finding of a violation under Section 206(1), 15 U.S.C. Section 80b-6(1), which requires a finding that the petitioners acted with scienter. Id. The scienter requirement of Section 206(1) requires an analysis of petitioners' intent. The Second Circuit erroneously affirmed the Commission's finding that petitioners intended to defraud prospective clients without even addressing the ALJ's contrary finding, based upon her credibility determinations, that the petitioners did not intend to mislead prospective clients when creating the performance materials. Id.[4]

Based upon the violations that were found, the ALJ determined that a censure of VAS was in the public interest (App. A-60). No additional remedies were imposed by the ALJ. The ALJ found that the evidence did not support a finding of fraudulent intent, that there was no evidence of reliance by prospective clients or gain to petitioners, that the infraction was isolated and the petitioners had an otherwise unblemished record, that petitioners immediately discontinued all questioned materials when issues were raised by the Commission's examiners, and that the likelihood of future violations was slim (App. A-59).

The Commission disagreed with the ALJ's findings and interpreted petitioners' actions as perpetrating a serious fraud

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[4] The Second Circuit also erroneously stated that the Commission had found that the Graph "distorted VAS' performance relative to other investment advisers by using data that were not comparable" (App. A-4). In fact, the Commission did not find that the comparison group employed by VAS was distorted (App. A-19). The ALJ found that petitioners chose the comparison group in good faith (A-40).

upon prospective clients and demonstrating a substantial likelihood of further misconduct (App. A-21). Based upon these findings, the Commission imposed the sanctions earlier described, including a requirement that the petitioners send a copy of the Commission's opinion and order, to all existing clients by certified mail, return receipt requested, and to all prospective clients for a period of one year. Based upon the Commission's finding that petitioners had acted with scienter, the Second Circuit affirmed the Commission's choice of sanction. 198 F.3d at 66-7.

REASONS FOR GRANTING THE WRIT

THE SECOND CIRCUIT ERRED BY FAILING TO CONSIDER THE COMMISSION'S REVERSAL OF THE ADMINISTRATIVE LAW JUDGE'S FINDINGS ON CRITICAL FACTUAL ISSUES WHICH WERE DEPENDENT UPON CREDIBILITY DETERMINATIONS.

The Supreme Court made clear nearly 50 years ago that a court of appeals must determine the substantiality of evidence supporting an agency decision by the record as a whole, including the decision of the ALJ. See Universal Camera Corp. v. NLRB, 340 U.S. 474, 493 (1951). In Universal Camera, the Court reviewed the legislative history of the Administrative Procedure Act and held that the ALJ's findings were entitled to special significance where, as here, credibility is important to the outcome of the case:

> We intend only to recognize that evidence supporting a conclusion may be less substantial when an impartial, experienced examiner who has observed the witnesses and lived with the case has drawn conclusions different from the Board's than when he has reached the same conclusion. The findings of the examiner are to be considered along with the consistency and inherent probability of testimony. The significance of his report, of course, depends largely on the importance of credibility in the particular case. 340 U.S. at 496.

Prior to the Second Circuit's decision in the instant case, the courts of appeal had followed Universal Camera precedent by expressly considering the ALJ's fact finding and subjecting agency decisions to closer scrutiny in cases of disagreement between the agency and ALJ on factual issues involving credibility. See e.g., Ward v. NLRB, 462 F.2d 8, 12 (5th Cir. 1972) ("when the ultimate determination of motive or purpose hinges entirely upon the degree of credibility of interested witnesses, the credibility findings of the Trial Examiner are entitled to special weight and are not to be easily ignored."); Pogue v. U.S. Dept. of Labor, 940 F.2d 1287, 1289 (9th Cir. 1991) ("Special deference is to be given the ALJ's credibility judgments."); WHW Enterprises, Inc. v. FCC, 753 F.2d 1132, 1142 (D.C. Cir. 1985); Kopack v. NLRB, 668 F.2d 946, 951 (7th Cir.), cert. denied, 456 U.S. 994 (1982); Colson Equipment, Inc. v. NLRB, 673 F.2d 221, 223-4 (8th Cir. 1982); Eastern Engineering & Elevator Co. v. N.L.R.B., 637 F.2d 191, 197 (3d Cir. 1980); Ewing v. NLRB, 732 F.2d 1117, 1120 (2d Cir. 1984).

Outside of the context of adminsitrative law, the Supreme Court has recognized the importance of a trial judge's opportunity to observe the demeanor of witnesses in cases turning on motive and intent. As the Court stated in United States v. Yellow Cab Co., 338 U.S. 338, 341 (1949), addressing a trial court's dismissal of conspiracy claims:

> Findings as to the design, motive and intent with which men act depend particularly upon the credit given to witnesses by those who see and hear them. If defendants' witnesses spoke the truth, the findings [of the trial court] are admittedly justified. The trial court listened to and observed the officers who had made the records from which the Government would draw an inference of guilt and concluded that they bear a different meaning from that for which the Government contends.

See also, Pullman-Standard v. Swint, 456 U.S. 273, 288 (1982). While petitioners recognize a different standard applies to review of agency decisions, see Universal Camera, 340 U.S. at 493, FCC v. Allentown Broadcasting Corp., 349 U.S. 358, 364

(1955), the reasoning behind the Supreme Court's decisions in Yellow Cab and Pullman-Standard clearly supports paying special deference to an ALJ's fact finding to the extent they are based upon credibility determinations.

Expressly crediting petitioner Valicenti's testimony, the ALJ found that petitioners did not subjectively intend to defraud any prospective clients. The Commission rejected petitioner Valicenti's testimony and, based upon its view of the record, concluded that petitioners intended to commit fraud. The Commission's decision in this case turned upon a finding of petitioners' subjective intent when creating the Chart and Graph. In the instant case, the ALJ found that petitioner Valicenti was a credible witness and, based in part upon his testimony, found as a matter of fact that petitioners had not acted with any intent to defraud prospective clients (App. A-59). The ALJ found the testimony of the only other eyewitness to the creation of the performance materials (Peter Marchese, the former VAS employee who actually compiled the performance information and created the performance materials under Valicenti's supervision) to be "cautious, bordering on evasive" (App. A-31). The Commission expressly acknowledged that it was overruling the ALJ on credibility issues (App. A-20). Nevertheless, the Second Circuit failed to even address the ALJ's fact findings.

In the instant case, the Second Circuit failed to consider the ALJ's fact findings on credibility issues, or indeed to even mention the initial decision which the Commission reversed. The Second Circuit's flawed analysis represents an important departure from the required standard of review of administrative decisions by courts of appeals under the Administrative Procedures Act and the Advisers Act. If the Commission's reversal of ALJ credibility determinations are not closely scrutinized by the courts upon review, there will remain little incentive for agencies to even consider the ALJ's credibility determinations. Indeed, there exists the real possibility that justice will be conveniently sacrificed for policy making goals within the administrative system.

In this case, the Commission wove its desired conclusion from whole cloth. The Commission's conclusions about petitioners' definitions of various terms which appear in the performance materials are not supported by substantial evidence in light of the ALJ's crediting of petitioner Valicenti's testimony. The evidence relied upon by the Commission to ascribe fraud to the petitioners is ambiguous and equally supports the ALJ's findings. The record as a whole, when the ALJ's credibility determinations are given proper weight, lacks substantial evidence to support the Commission's finding that petitioners acted with scienter. By failing to closely scrutinize the Commission's reversal of the ALJ's fact finding, the Second Circuit has effectively eroded this Court's precedent for substantial evidence review as laid down in Universal Camera and its progeny. The Second Circuit's failure to properly scrutinize the Commission's reversal of ALJ fact finding resulted in an erroneous affirmance of the Commission's decision below.

CONCLUSION

For all of the reasons identified herein, a writ of certiorari should issue to review the decision of the United States Court of Appeals for the Second Circuit and, ultimately, vacate the Court of Appeals decision affirming the order of the Securities and Exchange Commission.

Respectfully submitted,

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APPENDIX

AMENDED OPINION

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

August Term, 1999

(Argued: September 8, 1999 Decided: November 30, 1999)

Amended: February 9, 2000

Docket No. 99-4002

VALICENTI ADVISORY SERVICES, INC. and VINCENT R. VALICENTI,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Before: FEINBERG, CALABRESI and SOTOMAYOR, *Circuit Judges.*

On Petition for review of an opinion and order of the Securities and Exchange Commission finding petitioners in violation of the Investment Advisers Act, 15 U.S.C. § 80b-1 *et. seq.* (1994 & Supp. 1999), and imposing sanctions.

Affirmed.

STEVEN E. COLE, Wolford & Leclair LLP, Rochester, New York (Michael R. Wolford, Wolford & Leclair LLP, Rochester, New York, of counsel), *for petitioners.*

MARK PENNINGTON, Securities and Exchange Commission, Washington D.C. (*Harvey J. Goldschmid, General* Counsel, Jacob H. Stillman, Solicitor, Robert C. Stacy II, Attorney, David M. Becker, Deputy General Counsel, Securities and Exchange Commission, Washington, D.C., of counsel), *for respondent.*

PER CURIAM:

Petitioners Valicenti Advisory Services, Inc. ("VAS") and Vincent R. Valicenti appeal from an opinion and order of the Securities and Exchange Commission ("SEC" or "Commission") finding that VAS, aided and abetted by Valicenti, willfully violated various anti-fraud provisions of the Investment Advisers Act ("IAA"), 15 U.S.C. §80b-1 *et seq.* (1994 & Supp. 1999), and imposing various sanctions. For the reasons to be discussed, we affirm.

BACKGROUND

Valicenti is the president and sole owner of VAS, an advisory organization registered with the SEC. Throughout 1992, petitioners distributed a packet of marketing materials to prospective clients. That packet contained a chart developed by petitioners which purported to show VAS's rates of return on its "Total Portfolio" between 1987 and 1991 (the "Chart"). On the Chart, a footnote next to "Total Portfolio" indicated that the displayed figures represented a "composite of discretionary accounts with a balanced objective."[1]

In December 1993, the SEC commenced an inspection of VAS, at which time the Commission became aware of the Chart. The SEC found the Chart to be materially misleading because: (1) a reasonable investor would have understood a

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[1] Discretionary accounts are those accounts over which VAS exercised full discretionary authority because the clients had placed no restrictions on their management.

"composite" to include *all* "discretionary accounts with a balanced objective"; (2) the Chart reflected the performance of only a selected *portion* of VAS's "balanced" accounts; and (3) the rate of return ("ROR") for 1991 indicated on the Chart was more than seven percentage points higher than it would have been had the Chart incorporated all of VAS's balanced accounts for that year.

The Commission also found that petitioners acted with a deliberate intent to defraud. In so finding, the Commission relied upon the following facts:

- Valicenti rejected recommendations by the VAS marketing manager that the Chart disclose more information, including, *inter alia,* methodology, the number of accounts reflected in the Chart, and the value of the largest and smallest accounts.

- Valicenti included in the Chart only a small and distorted subset of balanced accounts. Specifically:

  (1) Valicenti excluded from the Chart accounts valued under $100,000. The Chart did not mention this exclusion, event though 27% to 45% of VAS's balanced accounts between 1987 and 1991 were valued under $100,000.

  (2) After reviewing a preliminary calculation that reflected an overall performance of –0.84% for 1987, Valicenti directed the VAS marketing manager to exclude from the final calculation six accounts with negative RORs for that year and to add two other accounts that had performed positively that year. As a result of these changes, the total performance figure for 1987 went from –0.84% to +2.60%.

- Valicenti included accounts that fell outside his definition of a "balanced" account, i.e., the equity

portion of the account be no greater than 70% and no less than 30%.[2]

- Valicenti created and distributed in the marketing packet another document containing a bar graph that distorted VAS's performance relative to other investment advisors by using data that were not comparable.[3]

Accordingly, the SEC found that both petitioners had violated § 206(1), §206(2), and § 206(4) of the IAA, 15 U.S.C. §§ 80b-6(1), 80b-6(2), 80(b)-6(4), as well as SEC Rule 206(4)-1(a)(5), 17 C.F.R. § 275.206(4)-1(a)(5).[4] In light of these findings, the SEC sanctioned petitioners with a censure, a cease and desist order, and fines of $50,000 against VAS and $25,000 against Valicenti. The Commission also required petitioners to send copies of the Commission's opinion and order to all existing clients of VAS and, in the following year, to all prospective clients.

Valicenti and VAS petition this court for review of the SEC's opinion and order pursuant to 5 U.S.C §§ 702-706 (1994)

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[2] In a letter to the Commission, Valicenti explicitly defined a "balanced" account as an account with an asset mix ranging from 70% equity and 30% fixed income to 30% equity and 70% income ("the 70/30 definition"). He later testified, however, that the 70/30 definition was a "guideline" and that a "balanced" account was defined in terms of its investment objectives instead of its asset mix.

[3] Valicenti does not appeal this particular finding.

[4] Section 206(1) prohibits the "employ[ment of] any device, scheme, or artifice to defraud any client or prospective client." 15 U.S.C. § 80b-6(1). Section 206(2) makes unlawful "any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client." 15 U.S.C. § 80b-6(2). Section 206(4) proscribes "any act, practice, or course of business which is fraudulent, deceptive, or manipulative" and provides that the SEC shall promulgate rules thereunder. 15 U.S.C. § 80b-6(4). SEC Rule 206(4)-1(a)(5), promulgated pursuant to § 206(4), prohibits the publication of any advertisement "[w]hich contains any untrue statement of a material fact, or which is otherwise false or misleading." 17 C.F.R. § 275.206(4)-1(a)(5).

and 15 U.S.C. § 80b-13 (1994). They argue that the evidence in the record is insufficient to support either the finding of scienter or the finding that the Chart was materially misleading. They also argue that the finding that petitioners violated the securities laws offended due process, because they had insufficient notice that their conduct was unlawful. Finally, petitioners argue that the sanctions exceeded the SEC's statutory authority and constituted an abuse of discretion. For the reasons that follow, we reject these arguments.

DISCUSSION

In reviewing the SEC's opinion and order, we must affirm "[t]he findings of the Commission as to the facts, if supported by substantial evidence." 15 U.S.C. § 80b-13(a). The "traditional standard used for judicial review of agency actions ... is deferential, and we may neither engage in our own fact-finding nor supplant the [SEC's] reasonable determinations." *Cellular Tel. Co. v. Town of Oyster Bay,* 166 F.3d 490, 494 (2d Cir. 1999) (citation and internal quotation marks omitted).

I. *Scienter*

Whether petitioners acted with the requisite mental state is a question of fact. *See Grandon v. Merrill Lynch & Co.,* 147 F.3d 184, 194 (2d Cir. 1998). "Proof of scienter" under the securities laws "need not be direct, but may be 'a matter of inference from circumstantial evidence.'" *Wechsler v. Steinberg,* 733 F.2d 1054, 1058 (2d Cir. 1984) (quoting *Herman & MacLean v. Huddleston,* 459 U.S. 375, 390 n.30 (1983)); *see also Shields v. Citytrust Bancorp, Inc.,* 25 F.3d 1124, 1128 (2d Cir. 1994) (stating that, in securities fraud cases, a "'strong inference' of fraud may be established ... [from] circumstantial evidence of conscious misbehavior or recklessness").

Petitioners mount a misguided effort to attack the evidence on which the Commission relied in finding that petitioners acted with deliberate intent to defraud.[5] For example, they downplay the significance of Valicenti's decision to reject the marketing manager's recommendations that the Chart provide greater disclosure, by emphasizing that the recommended disclosures are nowhere required by law. They also contend that, because Valicenti's decisions to include and exclude certain accounts resulted in only a small increase in reported performance for just one of the displayed years, his selective inclusion and exclusion of accounts must not have been motivated by an intent to defraud investors. Furthermore, they point to facts from which petitioners' good faith might be inferred, e.g., that on occasion they more accurately described the Chart to prospective clients as being "based on a sampling of portfolios" or that Valicenti decided not to distribute an updated Chart depicting portfolio performances for 1988-1992 because he was concerned about its accuracy.

These arguments, however, misapprehend the nature of our review of an administrative agency's decision. Petitioners essentially argue that this court should draw inferences from the evidence contrary to those drawn by the Commission. In other words, they ask us to "supplant the [administrative agency's] reasonable determinations." *Cellular Tel.*, 166 F.3d at 494. But based on the record — which shows that Valicenti consciously rejected his marketing manager's recommendations to provide

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[5] We note that at least two circuits have held that § 206(1) of the IAA requires a finding of fraudulent intent. *See SEC v. Steadman*, 967 F.2d 636, 641 &n.3 (D.C. Cir. 1992); *Steadman v. SEC*, 603 F.2d 1126, 1134 (5th Cit. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *see also Messer v. E.F. Hutton & Co.*, 847 F.2d 673, 677-78 (11th Cir. 1988) (per curiam) (relying on, *inter alia*, the Fifth Circuit's decision in *Steadman* to find scienter requirement in another anti-fraud provision of the securities laws containing language parallel to that of § 206(1)). Because we uphold the Commission's finding of intent to defraud with respect to each violation, however, we do not need to reach the question of whether §206(1) imposes such a scienter requirement.

more disclosure, chose to exclude accounts valued under $100,000 because of their higher transactional costs, decided to add accounts with positive RORs, struck from the list accounts with negative RORs, and created another document which inflated VAS's performance relative to other investment advisers — we cannot say that the SEC lacked "such relevant evidence as a reasonable mind might accepts as adequate to support [its] conclusion." *Universal Camera Corp. v. NLRB,* 340 U.S. 474, 477 (1951) (quoting *Consolidated Edison Co. v. NLRB,* 305 U.S. 197, 229 (1938)) (internal quotation marks omitted). We thus uphold the SEC's finding of scienter.

II. *Materiality*

Petitioners also argue that the Chart was not materially misleading because Valicenti's decision to exclude and include various accounts resulted in, by their tally, a change in VAS's overall performance figure or no more than 1% for 1987 and 0.22% over the five years of performance presented in the Chart. Such differences, they argue, would not be material to the reasonable investor. *See Press v. Chemical Inv. Servs. Corp.,* 166 F.3d 529, 538 (2d Cir. 1999) (noting that "material" information under the securities laws is "information that would have assumed actual significance in the deliberations of the reasonable [investor])" (citations and internal quotation marks omitted).

The SEC points out, however, that although the Chart reflected an ROR for 1991 of 27.89%, all of VAS's 122 balanced accounts for that year reflected a total ROR of 20.63%. The Commission found the discrepancy of seven percentage points in the ROR reported for 1991 to be "[m]ost significant" and therefore sufficient to establish the materiality of the Chart's misrepresentation. We will not supplant the SEC's reasonable decision to rely upon such data. *See Cellular Tel. Co.,* 166 F.3d at 494. Even petitioners do not claim that a 7% disparity would not be material. We therefore affirm the Commission's finding that the Chart was materially misleading.

III. *Due Process*

Petitioners next contend that it violates due process to hold that they violated the securities laws. They assert that, because the SEC has not promulgated regulations articulating specific standards for performance advertising, they did "not receive [] fair notice of [what constitutes] a regulatory violation." *Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996). Due process requires, however, only that "laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited." *Id.* (citing *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972)). Here, the SEC sanctioned petitioners for intentionally misrepresenting past performance. Neither VAS, a registered investment adviser, nor Valicenti, who has worked in the investment industry since 1967, can credibly claim lack of fair notiee of the proscription against defrauding investors. Their due process claim therefore lacks merit.

IV. *Sanctions*

Petitioners challenge the SEC's imposition of monetary sanctions, the issuance of a cease and desist order, and the requirement that current and future clients be provided with a copy of the Commission's opinion and order ("the distribution requirement").[6] We review the Commission's imposition of sanctions for abuse and discretion. *See Markowski v. SEC*, 34 F.3d 99, 105 (2d Cir. 1994).

We will find an abuse of discretion if the sanctions imposed are either unwarranted in law or without justification in fact. *See United States v. International Bhd. of Teamsters*, 170 F.3d 136, 144 (2d Cir. 1999) (citation omitted). The sanctions imposed in this case are both within the SEC's statutory authority and justified under the circumstances. The Commission is empowered to assess monetary penalties of $50,000 against a natural person or $250,000 against a company for willful and fraudulent violations of the IAA. 15 U.S.C. § 80b-3(i)(2)(B)

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[6] Petitioners have waived any challenge to censure sanction by apparently conceding that it would have been appropriate upon a finding of negligence. Accordingly, it is also appropriate upon a finding of more serious misconduct, *i.e.*, fraud.

(1994). The Commission may also issue cease and desist orders that would "require [a violator] to comply, or take steps to effect compliance" with the provisions they violated. 15 U.S.C. § 80b-3(k)(1) (1994). Moreover, the Commission is empowered to "place limitations on the activities" of violators, suspend them for up to twelve months, or bar them entirely from the investment advising business. 15 U.S.C. § 80b-3(e), (f) (1994 & Supp. 1999). In determining whether to impose statutorily authorized monetary penalties, the Commission is to consider "whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement." 15 U.S.C. § 80b-3(i)(3)(A) (1997). With respect to cease and desist orders, the Commission is authorized to impose such an order "as the Commission deems appropriate" to effect a violator's compliance with the statute. 15 U.S.C. § 80b-3(k)(1). As for other "limitations" on activities, the statute provides that the Commission shall impose such sanctions if it finds that any violation of the IAA was done willfully. 15 U.S.C. § 80b-3(e)(5) (1994). Having upheld the SEC's finding that petitioners acted with an intent to defraud, we conclude that the monetary sanctions, the cease and desist order, and the distribution requirement were all justified under the circumstances.

Petitioners argue further that the Commission abused its discretion by imposing the distribution requirement because the imposition of such a sanction was "excessive" and "bore no rational relationship to the violations found." Although we recognize that the imposition of a sanction that is "palpably disproportionate to the violation" may be an abuse of discretion, *see Reddy v. Commodity Futures Trading Comm'n,* 191 F.3d 109, 124 (2d Cir. 1999), the distribution requirement here was rationally connected to the particular conduct at issue, *see id.* As we observed above, the IAA authorizes the SEC to "place limitations on the activities" of violators of the statute. 15 U.S.C. § 80b-3(e), (f). We see no reason why the distribution requirement might not be an appropriate and reasonable "limitation" in certain circumstances. In this regard, we note that the IAA explicitly permits the imposition of sanctions that are

plausibly *more severe* that the distribution requirement, including revocation of the petitioners' registration and suspension for up to 12 months, *see id.,* each of which would likely result in greater loss of income and stigmatization than having to furnish copies of the SEC's opinion and order to existing and prospective clients for one year.

Moreover, the SEC has provided at least two reasonable explanations justifying the imposition of the distribution requirement as a reasonable "limiation" on petitioners' investment adviser activities. First, the distribution requirement will apprise present and prospective clients of the Commission's findings so that these investors may be fully informed in deciding whether they wish to do business with petitioners. Second, the distribution requirement may discourage petitioners from committing further violations. Given the serious nature of the petitioners' violations, we cannot deny that the distribution requirement is a rational means to alert actual and prospective clients of petitioners' misconduct and to discourage any further such conduct. *See Reddy,* 191 F.3d at 124 "([S]o long as an agency has articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choice made, we will uphold its choice of sanctions.") (citations and internal quotation marks omitted); *County Produce, Inc. v. United States Dep't of Agric.,* 103 F.3d 263, 266 (2d Cir. 1997) (noting the "fundamental principle that where Congress has entrusted an administrative agency with the responsibility of selecting the means of achieving the statutory policy[,] the relation of remedy to policy is a peculiarly a matter for administrative competence") (citation and internal quotation marks omitted).

Finally, petitioners argue that the distribution requirement was an abuse of discretion because the Commission has never before imposed such a sanction against an investment adviser in a litigated case. The Commission, however, has previously imposed sanctions similar to the distribution requirement here in investment adviser advertising cases that have been settled. *See, e.g., In re Consolidated Fin. Advisors,*

Inc., 65 SEC Dkt. 1414 (Sept. 26, 1997); *In re Wall Street Money Mgmt. Group, Inc.*, 58 SEC Dkt. 1953 (Jan. 30, 1995); *In re Harvest Fin. Group*, 42 SEC Dkt. 1327 (Feb. 21, 1989); *In re Blue Chip Market Advisor, Inc.*, 44 SEC Dkt. 1467 (Oct. 25, 1989); We find no indication that the SEC singled out petitioners for particularly severe punishment. *Cf. Winkler v. SEC*, 377 F.2d 517, 518 (2d Cir. 1967) (warning that the court must be "watchful" of whether sanctions have been applied in an "unduly harsh" or "discriminatory" manner). Moreover, petitioners have not identified any particular instances in which persons who intentionally misled their clients received more lenient treatment. Accordingly, we find that the sanctions imposed by the Commission do not constitute an abuse of discretion.

CONCLUSION

Having reviewed the record and examined petitioners' arguments and having found those arguments to be without merit, we affirm the opinion and order of the Securities and Exchange Commission.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 1774 / November 18, 1998

Admin. Proc. File No. 3-8854

In the Matter of
VALICENTI ADVISORY SERVICES, INC.
100 Baldwin Street
Elmira, New York 14901

and

VINCENT R. VALICENTI

OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDINGS

Ground for Remedial Action

Fraudulent Sales Literature

Registered investment adviser and its president distributed two pieces of fraudulent sales literature to prospective clients. Held, it is in the public interest to censure and fine respondents, to issue a cease and desist order, and to require respondents to send a copy of the Commission's opinion and order to clients and, for one year, to prospective clients.

APPEARANCES:

Michael R. Wolford and Steven E. Cole, of Wolford & Leclair LLP, for Valicenti Advisory Services, Inc. and Vincent R. Valicenti.

Carmen J. Lawrence, Henry Klehm III, Daniel J. Goldstein, Samuel C. Watkins, Brian H. Fortune, and Daniel C. Feldman, for the Division of Enforcement.

Appeal filed: July 30, 1997
Briefing completed: October 22, 1997
Oral argument: July 7, 1998

I.

Valicenti Advisory Services, Inc. ("VAS" or "the firm"), a registered investment adviser, and our Division of Enforcement appeal from the initial decision of an administrative law judge. The law judge found that VAS willfully violated Sections 206(2) and 206(4) of the Investment Advisers Act ("Act") and Rule 206(4)-1(a)(5) thereunder by negligently misrepresenting certain facts in two pieces of promotional literature.[1] The law judge also found that, although Vincent R. Valicenti ("Valicenti"), VAS's president and sole owner, was a "cause" of the firm's violations within the meaning of Section 203(k)(1) of the Act, he did not aid and abet the violations. The law judge concluded that VAS should be censured, and that the proceedings against Valicenti should be dismissed.

VAS argues that the law judge's findings of violation are erroneous, and that the proceedings against the firm should also be dismissed. The Division contends that VAS and Valicenti ("respondents") acted with scienter in issuing four pieces of fraudulent sales literature; that respondents made material misrepresentations in addition to those found by the law judge; and that a cease and desist order as well as significant sanctions and penalties should be imposed on respondents. Our findings are based on an independent review of the record.

II.

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[1] Section 206(2) (15 U.S.C. § 80b-6(2)) prohibits any transaction, practice, or course of business that operates as a fraud on any client or prospective client. Section 206(4) (15 U.S.C. § 80b-6(4)) prohibits engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative. Rule 206(4)-1(a)(5) (17 C.F.R. § 275.206(4)-1(a)(5)) prohibits the distribution of any advertisement that contains any untrue statement of a material fact or is otherwise false or misleading.

In early 1992, Valicenti decided to prepare materials advertising VAS's past performance for distribution to prospective clients. Peter Marchese, VAS's marketing manager, was assigned the task of preparing the necessary materials subject to Valicenti's specifications and close supervision. The law judge's findings of violation are based on the two pieces of sales literature that resulted, both of which were distributed to VAS prospects in 1992. The literature consisted of the chart and bar graph that are described below.

A. The 1991 Chart

The 1991 Chart ("Chart") purported to show the rates of return realized by a "composite of [VAS] discretionary accounts with a balanced objective" over the five-year period 1987 through 1991.[2] According to Valicenti, in order to be considered "balanced," and therefore included in the Chart, an account's objectives "could not be at the extremes of high income or ... growth," which he defined as any account with equity or bond holdings in excess of 70% of the total portfolio.[3] Under Valicenti's definition, the assets of a balanced account had to be a mix consisting of between 30% and 70% equities and 30% and 70% bonds.

In 1987, VAS had approximately 74 balanced accounts meeting Valicenti's definition, in 1988 about 112 such accounts, and in each of the years 1989 through 1991 more than 120 such accounts. However, very few of these accounts were reflected in the 1991 Chart. Indeed, the Chart's rates of return reflected only 13 accounts for 1987, 17 accounts for 1988, and 19 accounts for each of the years 1989 through 1991. These accounts were selected from an original list of 22 chosen by Valicenti (from the

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[2] Rates of return were shown separately for the accounts' total portfolio, the bond component of that portfolio, and the equity component of the portfolio. The Chart also showed cumulative rates of return for two, three, four, and five-year periods.

[3] All of VAS's accounts were "discretionary."

more than 400 under VAS management in 1991) and assigned to Marchese for the calculation of performance results.

We agree with respondents that, in the present context, the term "composite" simply means "compound"[4] or "combination". However, we consider that, when, as here, an adviser's sales literature states that the rates of return it is advertising are based on the combined performance of certain specified accounts, the plain meaning of that statement is that the rates reflect the performance of all accounts falling within the stated criteria, not merely a few chosen by the adviser. Our conclusion is supported by expert testimony in the record.

Dr. Robert Hagin testified that it is a clear convention in the advisory industry that, when the term "composite" is used, it means all accounts that meet the stated criteria, and established practice in the industry since at least 1973. There must be "no sampling" and "no selectivity." Dr Scot Lummer agreed with Hagin. Lummer stated that, in 1992, the word "composite" had a specific, well understood meaning in the investment adviser community — the average of all accounts that met the specified criteria. Lummer stated, moreover, that a large percentage of investors who focus on performance numbers understand the meaning of the term "composite." Even Dr. Jeffrey Lessard, one of respondents' experts, conceded that respondents' use of the term "composite" to describe their results "may have been technically inaccurate."[5]

Respondents argue that, in any event, the Division did not show that respondents misrepresented VAS's performance; i.e., the Division did not establish that the actual performance of VAS's discretionary, balanced accounts for the years in question was materially different from that depicted in the 1991 Chart.

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[4] The American Heritage Dictionary, Second College Edition (1985).

[5] We find contrary testimony by respondents' other experts unconvincing. One of them, John Piccione, went so far as to claim that the actual performance of a single account could be a composite.

We do not agree. In our view, the evidence is more than sufficient to justify the conclusion that the results reported in the Chart were materially misleading. Most significant is the following evidence concerning the firm's performance for 1991.

In the course of the Division's investigation, respondents were asked to supply a list of all accounts for the years 1987 through 1991 that met Valicenti's criteria for inclusion in the Chart. Since pre-1991 data were not available in VAS's computer system, respondents only supplied a list of such accounts for 1991. That list totalted 122 accounts and disclosed that the accounts' combined 1991 rate of return was only 20.629%, a figure more than 7% lower than the rate of 27.89% shown on the Chart for 1991.

Respondents now question the accuracy of the information they themselves submitted to our staff. They claim that Valicenti did not know how the 122 accounts were selected; that the list improperly included accounts that were opened during 1991; and that the rate of return calculated for the accounts was not "market-weighted" like the other rates on the 1991 Chart.[6] These contentions are without merit. The record contains a letter from Valicenti to our staff describing in detail the criteria used in selecting the 122 accounts. Moreover, Joseph Valicenti ("J. Valicenti"), a VAS portfolio manager (and Valicenti's son), recalculated the rate of return for the accounts on the list leaving out those that assertedly were improperly included. The result was a 21.76% rate of return, only 1.1% higher than the rate originally supplied to our staff. J. Valicenti also calculated the market-weighted rate of return for the 122 accounts and arrived at a figure of 22.70%, still more than 5% lower than the 27.89% rate shown on the 1991 Chart.

A wealth of other evidence demonstrates that respondents were intent on presenting a misleading portrayal of VAS's past performance. While purporting to be a composite of all balanced accounts managed by VAS, the Chart, as noted above, was based

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[6] Market-weighted rates of return take into account the size of an individual portfolio in relation to the total of all portfolios.

on only 13 to 19 accounts, although the number meeting Valicenti's definition ranged from about 74 to more than 120 during the years in question. Moreover, as the law judge found, Valicenti rejected all of Marchese's suggestions that would have provided more disclosure.[7] Thus, Valicenti rejected proposed disclosure that, among other things, would have revealed that the cited rates of return only reflected "a sample of discretionary accounts." Valicenti also chose not to disclose the actual number of accounts reflected in the Chart for each of the years in question.

Although the percentage of VAS balanced accounts with less than $100,00 in assets ranged from about 28% to 45% of all such accounts during the years 1987 through 1991, Valicenti determined that the Chart should only include accounts with more than $100,000 in assets. He stated that accounts with less than that figure were very difficult to manage on a performance basis because of their very high transaction costs. No disclosure of the $100,000 requirement was made in the Chart. In fact, Valicenti rejected proposed disclosure that would have revealed the size of included accounts.

The record does not show, and respondents do not claim, that the Chart was shown only to prospective clients with more than $100,000 to invest. We agree with Dr. Lummer that the Chart was materially misleading to VAS prospects who wanted to invest less than $100,000.

The record further reveals that Valicenti tinkered with the results calculated by Marchese in order to show higher rates of return. At Valicenti's direction, Marchese prepared, and showed to Valicenti, a number of interim spreadsheets showing five-year performance figures for various combinations of the 22 accounts initially selected by Valicenti. One of the spreadsheets calculated the combined performance of 17 of those accounts for the year 1987. The calculation showed that the combined accounts had suffered a loss for the year, resulting in a –0.84% negative rate of return. Valicenti didn't like what he saw, and indicated to

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[7] As noted above, Peter Marchese was VAS's marketing manager.

Marchese that the spreadsheet "didn't look like a good representation." Thereafter, Valicenti directed Marchese to make changes with respect to six of the 17 accounts in his computation, all six of which had had a negative 1987 performance. Valicenti ordered that three of the accounts be dropped completely from the Chart, and that the other three be omitted for the year 1987. At the same time, he directed Marchese to add two other accounts to the Chart, both of which had had a positive 1987 performance.

By these expedients, Valicenti transformed a negative rate of return for 1987 (-0.84%) into a positive 2.60% rate for the year, the rate that appeared in the 1991 Chart. As noted above, the 2.60% rate that Valicenti achieved was based on only 13 of 74 accounts that met Valicenti's criteria. Valicenti claimed that the three accounts that were totally dropped were eliminated because they did not meet those criteria. However, he did not explain why the other three accounts apparently met his criteria for 1988 through 1991, but not for 1987. The 2.60% rate of return engineered by Valicenti not only improved the picture presented for 1987, but also boosted the cumulative rates of return shown in the 1991 Chart for the subsequent two to five-year periods.[8]

Other aspects of the Chart were also misleading. Although the Chart purported to report the performance of the same group of accounts over a five-year period, that was not the case. Instead, as Valicenti was aware (and as noted above), differing numbers of accounts were reflected for different years. Moreover, despite the fact that the Chart was purportedly limited to balanced accounts, not all of the included accounts fit that description. Indeed, as Dr. Hagin pointed out, 6 of the 13 accounts reflected in the Chart for 1987 did not meet Valicenti's definition.

Valicenti conceded that individual accounts in the Chart did not "necessarily" fall within his definition of "balanced". He stated, however, that, regardless of whether each individual account met his definition, his intent was to lump the assets of all

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[8] See n.2, supra.

the accounts in the Chart together and have the total reflect the appropriate mix of equities and bonds. This was clearly contrary to the Chart's representation that it reflected a composite of balanced accounts.

B. The 1991 Bar Graph

The 1991 Bar Graph ("Bar Graph") was also prepared by Marchese at Valicenti's direction. It purported to compare the five-year cumulative rates of return appearing on the Chart with the five-year performance of a sample of money managers. Valicenti instructed Marchese to order data from CDA Investment Technologies, Inc. that showed the performance results achieved by about 1135 money managers for accounts with a ratio of 50% equities to 50% bonds. The rates of return achieved by the money managers were shown in three columns; one showing the rates earned on a total portfolio equally divided between equities and bonds, the second showing the rates achieved for the portfolio's equity component, and the third showing the rates earned on the bond component. An asterisk was placed in each column indicating where VAS stood vis-a-vis the money managers.

The assets reflected in the Chart were composed of about 54% equities. Since equities outperformed bonds during the relevant period, comparing the rates of return appearing in the Chart with the rates achieved for account with only 50% equities resulted in a somewhat more favorable porttrayal of VAS's performance than was warranted. However, the record does not show that this circumstance improved the depiction of that performance in any material amount. Nevertheless, the Bar Graph was materially misleading since it compared the rates of return achieved by other money managers with the materially distorted VAS rates appearing in the Chart.

The Chart and the Bar Graph presented a false portrayal of VAS's performance and a misleading comparison of that performance with the performance of other money managers. Both of these items were materially misleading to prospective clients of the firm. We cannot agree with the law judge that, in

creating these documents, Valicenti acted in good faith. On the contrary, the record shows that, in an effort to win new clients, he deliberately distorted the truth.[9] Valicenti rejected all disclosure that would have revealed that, contrary to the Chart's stated coverage, it reflected only a small sampling of accounts that differed in number of different years. He excluded accounts under $100,000 because of their higher costs but refused to disclose that fact. He manipulated the narrow range of accounts included in the Chart in order to achieve better results. He improperly included non-balanced accounts in the Chart. And, finally, he created a misleading comparison of the Chart's distorted rates of return with the rates of other money managers.

We accordingly conclude that VAS, willfully aided and abetted by Valicenti, willfully violated Sections 206(1),[10] 206(2), and 206(4) of the Act and Rule 206(4)-1(a)(5) thereunder. We further conclude, pursuant to Section 203(k)(1) of the Act, that Valicenti was a cause of his firm's violations.[11]

As indicated above, the Division argues that respondents issued two additional pieces of fraudulent sales literature: 1992 updates of the Chart and Bar Graph. The law judge concluded that the record did not establish that the updates had ever been distributed to clients or prospective clients. On the basis of our review of the record, we are unable to conclude that the law judge erred in this regard. Accordingly, we make no findings with respect to these two items.

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9 As we have previously stated, credibility determinations can be overcome "only where the record contains 'substantial evidence' for doing so." See Anthony Tricarico, 51 S.E.C. 457, 460 (1993), and the authorities there cited. We find such evidence here.

10 Section 206(1) (15 U.S.C. §80b-6(1) Prohibits the employment of any device, scheme, or artifice to defraud any client or prospective client.

11 We have found that Valicenti acted with scienter. A respondent is a "cause" of another's violation if the respondent "knew or should have known" that his act or omission would contribute to such violation. Section 203(k)(1).

III.

Respondents argue that no sanctions are warranted. They assert, among other things, that their record in the advisory business is otherwise unblemished, that the advertisements at issue were an isolated occurrence, that no one was harmed by their actions, and that there is no basis for a cease and desist order since there is no reasonable likelihood of further violations on their part.

We take a less sanguine view of respondents' violations. Investment advisers are fiduciaries whose actions must be governed by the highest standards of conduct.[12] However, respondents chose to ignore those standards, and perpetrated a serious fraud on prospective clients of the firm. Contrary to the claim made by respondents, their actions demonstrate a substantial likelihood of further misconduct on their part.

Under all the circumstances, we have determined that it is appropriate in the public interest to censure respondents, to issue a cease and desist order, and to fine VAS $50,000 and Valicenti $25,000. We shall also require that respondents send a copy of our opinion and order to all of their existing clients and, for one year, to all prospective clients.

An appropriate order will issue.[13]

By the Commission (Chairman LEVITT and Commissioners JOHNSON and HUNT); Commissioners CAREY and UNGER not participating.

s\ Jonathan G. Katz
Jonathan G. Katz
Secretary

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[12] See, e.g., SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-192 (1963); Rosenfeld v. Black, 445 F.2d 1337, 1342-1344 (2d Cir. 1971).

[13] All of the contentions advanced by the parties have been considered. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 1774 / November 18, 1998

Admin. Proc. File No. 3-8854

In the Matter of

VALICENTI ADVISORY SERVICES, INC.
100 Baldwin Street
Elmira, New York 14901

and

VINCENT R. VALICENTI

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Valicenti Advisory Services, Inc. (VAS) and Vincent R. Valicenti (Valicenti) be, and they hereby are, censured; and it is further

ORDERED that VAS and Valicenti cease and desist from committing or causing any violation and committing or causing any future violation of Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act and Rule 206(4)-1(a)(5) thereunder; and it is further

ORDERED that, within 30 days of the entry of this order, VAS shall pay a civil money penalty in the amount of $50,000, and Valicenti shall pay a civil money penalty in the amount of $25,000, to the United States Treasury. Such payment shall be: (i) made by the United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) hand-

delivered or mailed to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (iv) submitted under cover letter which identifies VAS and Valicenti as respondents in this proceeding, and the file number of this proceeding. A copy of the cover letter and check shall be sent to Daniel J. Goldstein, counsel for the Division of Enforcement, Securities and Exchange Commission, Northeast Regional Office, 7 World Trade Center — 13th floor, New York, N.Y. 10048; and it is further

ORDERED that VAS and Valicenti (respondents) shall mail a copy of this opinion and order, together with a cover letter in a form acceptable to the staff of the Commission, to each of their existing clients by certified mail, return receipt requested, within thirty (30) days from the date of this order. From the effective date of this order until the expiration of twelve (12) months, respondents shall provide a copy of this opinion and order to all prospective investment advisory clients not less than forty-eight (48) hours prior to entering into any written or oral investment advisory contract (or not later than the time of entering into such contract if the client has the right to terminate the contract without penalty within five (5) business days after entering into the contract). Also, within thirty (30) days from the date of this order, respondents shall execute and deliver to Daniel J. Goldstein at the Commission's Northeast Regional Office an affidavit that they have provided this opinion and order to their existing clients in accordance with the terms of this order. Finally, within thirteen (13) months from the date of this order, respondents shall execute and deliver to Daniel J. Goldstein at the Commission's Northeast Regional Office an affidavit that they have provided this opinion and order to their prospective clients in accordance with the terms of this order.

By the Commission.

s\ Jonathan G.Katz
Jonathan G. Katz
Secretary

INITIAL DECISION RELEASE NO. 111

ADMINISTRATIVE PROCEEDING
FILE NO. 3-8854

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of

VALICENTI ADVISORY SERVICES, INC., and VINCENT R. VALICENTI

INITIAL DECISION
July 2, 1997

APPEARANCES: James J. Tyne, Karim G. Lynn, and Jason Sabot for the Division of Enforcement, Securities and Exchange Commission

Michael R. Wolford and Steven E. Cole for Respondents Valicenti Advisory Services, Inc., and Vincent R. Valicenti

BEFORE: Carol Fox Foelak, Administrative Law Judge

I. INTRODUCTION

The Securities and Exchange Commission (Commission) instituted this proceeding on September 29, 1995, pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (Advisers Act). The Order Instituting Proceedings (OIP) alleges that Valicenti Advisory Services, Inc., (VAS), willfully aided and abetted by Vincent R. Valicenti, willfully violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rules 206(4)-1(a)(2) and 206(4)-1(a)(5) thereunder.

I held a hearing in Washington, D.C., on January 16 through 19, 1996, (the January hearing), and on April 23, 1996, (the

April hearing).[1] At the January hearing, the Division of Enforcement (Division) called six witnesses, including Respondent Valicenti, and Respondents called five, including Respondent Valicenti. At the April hearing,[2] Respondents called two, and the Division, one, expert witnesses. A number of exhibits were received into evidence.[3] I considered the following post hearing pleadings: i) the Division's Post-Hearing Memorandum, dated June 7, 1996; ii) Respondents' Proposed Findings of Fact and Conclusions of Law and Post-Hearing Memorandum, dated June 6, 1996; iii) the Division's Post-Hearing Reply Memorandum and Reply to Respondents' Proposed Findings of Fact, dated June 28, 1996; and iv) Respondents' Post-Hearing Reply Memorandum, dated June 27, 1996.

ALLEGATIONS

The OIP alleges that, from approximately mid-1992 to approximately December 1993, VAS, willfully aided and abetted by Mr. Valicenti, willfully violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, by distributing and causing to be distributed, to clients and prospective clients, charts and bar graphs that falsely and misleadingly portrayed the Respondents' performance. The OIP also alleges that, from approximately 1992 to approximately December 1993, VAS, willfully aided and abetted by Mr. Valicenti, willfully violated Section 206(4) of the Advisers Act and Rules 206(4) of the Advisers Act and Rules 206(4)-1(a)(2) and 206(4)-1(a)(5) thereunder, by distributing and causing to be distributed, to clients and prospective clients, a hypothetical customer portfolio, the M.R. Sample, that misleadingly showcased some, but not all, of the Respondents' recommended

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[1] References to the January hearing transcript will be cited as "(Tr. __)," and references to the April hearing transcript will be cited as "(Apr. Tr. __)."

[2] I reopened the hearing to receive expert testimony related to issues raised by the Division's expert witness at the January hearing.

[3] References to Division exhibits will be cited as "(Div. Ex. __)," and references to Respondents' exhibits will be cited as "(Resp. Ex. __)."

securities, and was also misleadingly suggestive of performance for those securities.

BACKGROUND

Historically, investment advisers have been less closely regulated than other industries under the Commission's jurisdiction. There are fewer, less detailed, rules concerning investment advisers than, for example, investment companies. For example, Rule 482, (promulgated under the Securities Act of 1993), 17 C.F.R. § 230.482, contains detailed requirements concerning performance advertising by investment companies. By contrast there is no comparable specification of requirements for performance advertising by investment advisers. Advisers Act Rule 206(4)-1, 17 C.F.R. § 275.206(4)-1, involved in this case, pertains generally to advertisements by investment advisers.

In recent years the number of investment advisers and assets under management have increased greatly, as have the number of unsophisticated clients. Investment Advisers, General Accounting Office, at 10 (1990). House and Senate hearings in 1992 and 1993 on proposed investment adviser legislation described such problems as investment advisers' misappropriating client funds or putting them in unsuitable investments, conflicts of interest and failure to disclose them, as well as the growth in the number of investment advisers and

unsophisticated clients.[4] Also noted were inadequate Commission resources to conduct inspections of investment advisers. Subsequently legislation[5] was passed, and on April 4, 1997, the Commission announced the creation of the Task Force on Investment Adviser Regulation that is charged with, inter alia, developing proposals to modernize investment adviser regulations "in light of developments in the market place, the investment advisory industry, and the new legislation." Press Statement 97-30 (April 4, 1997).

This case involves alleged inaccurate performance advertising, not one of the abuses noted above. It developed from a Commission compliance examination of VAS conducted from December 7 through 16, 1993.[6] (TR. 14, 54-55, 824-27.)

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[4] Investment Adviser Industry Reform: Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. On Energy and Commerce, 102d Cong. (1992); House Comm. On Energy and Commerce, Investment Adviser Regulatory Enhancement and Disclosure Act of 1992 (to accompany H.R. 5726), H. Rep. No. 102-883 (1992); Investment Adviser Industry Reform: Hearing on H.R. 578 Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong. (1993); SEC Oversight of Investment Advisers: Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 102d Cong. (1992); Senate Comm. on Banking, Housing, and Urban Affairs, The Investment Adviser Oversight Act of 1992 (to accompany S. 2266), S. Rep. No. 102-312 (1992); Senate Comm. on Banking, Housing, and Urban Affairs, The Investment Adviser Oversight Act of 1993 (to accompany S. 423), S. Rep. No. 103-177 (1993).

[5] National Securities Markets Improvement Act of 1996, Title III, Investment Advisers Supervision Coordination Act, Pub. L. No. 104-290, 110 Stat. 3416, 3436-40 (codified as amended in scattered sections of 15 U.S.C. § 80b-1 et. seq.).

[6] The examination resulted from a complaint from a former VAS client concerning an unrelated issue that was not disclosed in this proceeding. VAS was awarded, and collected, a money judgment in satisfaction of a debt against the former client. (Tr. 52, 830-32.)

II. FINDINGS OF FACT[7]

RESPONDENTS

Vincent Valicenti has a bachelor's degree in finance and management from the State University of New York at Albany. (Tr. 816; Div. Ex. 7 at 30.) He has been in the securities business since 1968. (Tr. 818.) He was employed in the trust department at the Marine Midland Bank until 1984, when he founded VAS with a partner in Elmira, New York; he became sole owner in December 1985. (Tr. 462.) VAS has been registered with the Commission as an investment adviser from 1984 to the present. (Tr. 463, 817.) Mr. Valicenti is the president and a director of VAS, oversees the firm's operations, and manages most of the VAS client portfolios. (Tr. 462-64.) At the end of 1984 VAS had about $14 or $15 million under management. (Tr. 817.) At the end of 1987 it had about $48 million; 1991, $86 million; and 1992, $102 million. (Div. Ex. 9.) In 1994, VAS had about 640 accounts, with an average size of $150,000 to $200,000. (Tr. 468-71.) At the time of the hearing, VAS had approximately 300 clients, with about 650 accounts. (Tr. 818-19.)

Most of VAS' clients are individuals. (Tr. 469.) VAS gets clients through referrals; it does not engage in mass mailings or telemarketing. (Tr. 302-03, 783-86, 818.) The accounts are discretionary, but VAS deals with clients individually and seeks to ascertain and accommodate a client's preferences, as well as taking account of such constraints as tax considerations and illiquid assets. (Tr. 417-18, 819, 837-39.) To ascertain a new client's objectives Mr. Valicenti considers such information as the client's tax returns, net worth, stage in life, and any expected windfalls or extraordinary expenses. (Tr. 840, 483-85; Div. Ex. 7 at 4, 17-20.) He plans for the client's income needs from fixed income securities. (Tr. 840, 486.) Then he evaluates the possibilities for growth; a client who can afford risk will have

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[7] My findings and conclusions are based on the record. I applied preponderance of the evidence as the applicable standard of proof. I have considered all proposed findings and conclusions and all contentions, and I accept those that are consistent with this decision.

more stock than one who can afford less risk. (Tr. 841, 486.) An account's objectives may change over time. (Tr. 842.)

Mr. Valicenti's and VAS' philosophy is risk-averse; he relates this to his being in the business during a lengthy market decline in 1973-74. (Tr. 841; Div. Ex. 7 at 3.) His approach is to use fundamental analysis and invest for the long term; he refrains from such speculative practices as short term purchases, trading, short sales, or margin transactions. (Tr. 464; Div. Ex. 7 at 25.) Mr. Valicenti invests client funds in securities he selects; others at the firm who manage client portfolios and invest client funds must choose from the supervised list, a list of securities approved by Mr. Valicenti to be bought, held, or accumulated in a customer's account.[8] (Tr. 472-73, 822-23.)

VAS assesses its management fee according to the market value of the account: 1%, annually, of the market value for the first $300,000; 0.75% on the next $500,000; and 0.50% on anything above $800,000. (Tr. 475-77, 819-20; Div. Ex. 7 at 29.) VAS collects the fee quarterly, at the end of the quarter to which it applies, based on the account's value at that time. (Tr. 475-77, 819-20; Div. Ex. 7 at 29.)

The Division attempted to depict Mr. Valicenti as an unreliable witness and impeach his testimony by pointing to alleged inconsistencies between his testimony at trial and his investigative testimony, alleged statements to other witnesses, and various documents he signed. (See e.g., Tr. 555-60; Div. Post-Hearing Memorandum at 6-10). Examination of the alleged inconsistencies shows that many are either meaningless or not inconsistencies.

For example, "Who chose the accounts?" refers to the composite of 22 accounts used to show VAS' performance. (Div. Post-Hearing Memorandum at 7.) The Division asserts that Mr.

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[8] As a normal practice, VAS did not reveal to clients the securities contained on the supervised list, or offer to show clients or prospective clients a list of all securities it was buying or holding. (Tr. 554, 877-78.) VAS did not have a supervised list, per se, for bonds. (Tr. 553.)

Valicenti testified at the hearing that he chose the accounts but had previously stated, including in investigative testimony, that he did not. Yet the Division's illustration of Mr. Valicenti's alleged inconsistent investigative testimony is actually a statement by a Division attorney. (Tr. 911.) Additionally, it is clear throughout the record that, from the beginning of the investigation, Mr. Valicenti held himself out as being responsible for the choice of accounts. (See, e.g., Tr. 36.) Another example, "What is DX. 25?" refers to Division Exhibit 25, which is a list of VAS' accounts on which the 22 accounts chosen for the composite are circled. (Div. Post-Hearing Memorandum at 8.) The Division argues that Mr. Valicenti's testimony that it was not he who actually circled the accounts is inconsistent with his testimony at Tr. 844-60 as to why he chose the circled accounts. It is not clear where the inconsistency lies. Again, the record shows that Mr. Valicenti always held himself out as being responsible for the choice of accounts.

VAS EMPLOYEES

Peter Mark Marchese was employed at VAS as marketing manager from December 1991 to January 1993. (Tr. 150, 288-89, 502, 869.) Mr. Marchese's duties at VAS focused on marketing and included calculating the performance of VAS accounts and creating a "marketing tool" for presenting the results. (Tr. 151-52, 502-03, 834-35; Div. Ex. 7 at 7; Div. Ex. 88.) He has an MBA with a concentration in finance from the State University of New York at Binghamton, but no previous experience with calculating rates of return or performance information. (Tr. 150, 252-57, 261.)

Mr. Marchese resigned as of January 1993 to avoid signing a confidentiality/non-compete agreement. (Tr. 150, 303-04.) When he left he signed an exit document stating that he had not kept any VAS materials, although he had, in fact, retained copies of materials he had prepared which he had taken home throughout 1992. (Tr. 246-51.) His explanation for this was that he was concerned with the methodology being used in calculating performance information and felt threatened by Mr. Valicenti. (Tr. 245-46.) He did not recall, however, whether he had

communicated any concern about the methodology to Mr. Valicenti and acknowledged that Mr. Valicenti's threat was not connected with preparing performance information. (Tr. 267-68.) At the hearing, his responses were cautious, bordering on evasive. (See, e.g., Tr. 247-50, 254-57, 259-268, 270-75, 280-82, 286-88, 309-11.)

David Reidy was employed at VAS from November 1989 to January 1994 as a securities analyst and, later, a portfolio manager. (Tr. 426-27; Div. Ex. 7 at 6, 30.) He reviewed securities, put trades in with brokers, reviewed portfolios, and met with clients. (Tr. 426-27.) He has animus against Mr. Valicenti, resulting from Mr. Valicenti's controlling management style and insistence on a covenant not to compete, which forced him to leave Elmira, against his wishes, after he left VAS in January 1994. (Tr. 146, 440-41.) He did, however, consider Mr. Valicenti to be a sound investment adviser, serving his clients' interests and his animus is tempered by his satisfaction with the job he eventually obtained in Atlanta in June 1994. (Tr. 425, 441, 454.)

Joseph Valicenti (Mr. J. Valicenti) works at VAS and is Mr. Valicenti's son. (Tr. 711, 795.) Mr. J. Valicenti was hired as a securities analyst in May 1991, was later promoted to assistant portfolio manager, and, in 1993, was promoted to portfolio manager. (Tr. 712-14, 795-96; Div. Ex. 7 at 6, 30.)

Joan Leto Rogers was employed at VAS from 1990 to 1994, first as a receptionist; in early 1992 her duties evolved into marketing support, including compiling the blue folder that was given to prospective clients. (Tr. 118-20, 136, 436-37.) Diane Rockwell is, and was at the time of the events in question, employed by VAS as an administrative assistant. (Tr. 666-67.) Nancy Lehman has been employed by VAS since June 1993; during 1993 her position was receptionist at VAS' satellite Corning, New York, office;[9] it was staffed by her full time, and by one of the portfolio managers on rotation; if a portfolio

[9] The Corning office was opened in approximately October 1992. (Tr. 303.)

manager had a client meeting in Corning, her duties included making sure that materials, including the blue folder, were ready for him. (Tr. 686-92.)

THE BLUE FOLDER

In late 1991 or early 1992, VAS developed a presentation and marketing packet, the blue folder, that was given out to prospective clients. (Tr. 479, 482-83, 715-16, 718; Div. Ex. 7.) The blue folder may have typically included Mr. Valicenti's business card; a staff profile with pictures; "M.R. SAMPLE" documents; a personal planning questionnaire; Form W-9; Form ADV; and pages titled "Company Overview," "Investment Process," "Performance," "Client Reports," and "Service Agreement." (Tr. 477-79; Div. Ex. 7.) When included, performance materials that are the subject of this proceeding — the 1991 Chart (Div. Ex. 3) and the 1991 Bar Graph (Div. Ex. 5A) — were placed at the end of the material in the blue folder. (Tr. 126, 137.) The items were assembled in the blue folder in a particular order that Mr. Valicenti required and that he demonstrated to all employees at a staff meeting. (Tr. 123, 125-26.) Before a meeting with a prospective client, some items might be added or removed. (Tr. 670-71.) VAS staff did not routinely provide the blue folders to walk-ins or callers; they were not provided in person or through the mail without an interview with a portfolio manager, usually Mr. Valicenti.[10] (Tr. 130-31, 143-46, 717-18, 784-86.) As to the Corning office, at least from June to December 1993, no blue folders were mailed out and the 1991 Chart and the 1991 Bar Graph were not included in the blue folders or requested by a portfolio manager. (Tr. 689-91.)

THE M.R. SAMPLE

The M.R. Sample was used as an example of a typical quarterly report sent to clients. (Tr. 555, 720-21; Div. Ex. 7 at

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[10] Ms. Rogers mailed some, "maybe between 20 and 100," blue folders at the direction of Mr. Valicenti or another portfolio manager. (Tr. 131.)

10-16; Div. Ex. 7A.) It reflected holdings and transactions in a hypothetical account, named "M.R. Sample," which had a portfolio of some of the equity securities on VAS' supervised list. (Tr. 552-553, 721-22, 822-23.) It demonstrated such transactions as deposits, withdrawals, dividends, purchases, sales, and splits. (Div. Ex. 7 at 10-16; Div. Ex. 7A.) VAS used it to explain its quarterly reports to prospective clients. (Tr. 555, 720-21.) The "Client Reports" page in the blue folder explained the components of VAS' client reports as shown in the M.R. Sample; it does not mention "performance." (Div. Ex. 7 at 8.) Nor could the M.R. Sample be used to calculate performance because it did not include the date of purchase. (Tr. 571, 823; Div. Ex. 7A.) Mr. Valicenti used the M.R. Sample from late 1990 until December 1993. (Tr. 552, 821, 823-24.)

Kenneth D. Gartrell, Ph.D., a Certified Public Accountant (CPA) and partner in Putnam, Hayes and Bartlett, a consulting firm with a large percentage of work in the areas of litigation support and public policy, testified as an expert witness in Respondents' direct case. (Tr. 916-20, 970-71; Resp. Ex. 65). He was offered as an expert in the areas of financial economics, accounting, organizations and markets, and statistics. He gave opinion testimony on several topics including the response of a reasonable investor to the M.R. Sample. (Tr. 921.) Dr. Gartrell opined that a reasonable investor would view the M.R. Sample as a sample client report and nothing more. (Tr. 968.)

THE 1991 CHART AND 1991 BAR GRAPH

In early 1992, Mr. Valicenti wanted a method of showing prospective clients VAS' performance; he wished to bid for the account of the Chemung County Foundation, which required a five year rate of return to be included in a bid. (Tr. 152, 491-92, 513-15, 833-35.) He selected 22 accounts, from the approximately 500 accounts under VAS management at the time, and told Mr. Marchese to begin compiling the information

necessary for calculating performance. [11] (Tr. 155-57, 247-49, 265, 516-17, 858; Div. Ex. 25; see also Div. Ex. 9.) Mr. Marchese spent most of his time from January to April 1992 on the project. (Tr. 158, 286-88.) It was a lengthy, manual, process because data from before 1991 was not available in VAS' computer system; Mr. Marchese had to obtain it from paper copies of clients' quarterly statements that VAS had archived. (Tr. 157, 515, 735-38.)

Mr. Marchese eventually created a chart (the 1991 Chart) entitled "ANNUALLY-COMPOUNDED TIME-WEIGHTED RATES OF RETURN."[12] (Tr. 152-55; Div. Ex. 3.) It showed "TOTAL PORTFOLIO," "BOND PORTFOLIO," and " EQUITY PORTFOLIO" rates of return of a "composite of discretionary accounts with a balanced objective"[13] over a five year period, from 1987 through 1991, with subsequent compounded returns for two, three, four, and five year periods. (Tr. 152-55; Div. Ex. 3.) Mr. Marchese also created a bar graph (the 1991 Bar Graph) that compared VAS' "PERFORMANCE COMPOSITE" to "THE CDA UNIVERSE" (a sample of "money managers"). (Tr. 214-18; Div. Ex. 5A.)

The Composite

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[11] There is some dispute as to whether Mr. Valicenti was the person who circled the 22 accounts on Division Exhibit 25. Mr. Marchese claims that Mr. Valicenti circled the accounts. (Tr. 155-56.) Mr. Valicenti denies that he circled the accounts. (Tr. 837, 888.) Regardless of who circled the accounts, Mr. Valicenti selected the accounts to include in the account composite.

[12] A time-weighted rate of return "measures investment performance . . . as a percentage of capital "at work," effectively eliminating the effects of additions and withdrawals of capital and their timing." JOHN DOWNES & JORDON ELLIOT GOODMAN, BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 607 (4 th ed. 1995).

[13] This phrase appears as a footnote. The asterisk referring the reader to the footnote appears next to "TOTAL PORTFOLIO." (Div. Ex. 3; See also Tr. 515-16.) It is clear from the context that the "BOND" and "EQUITY" components of the "TOTAL PORTFOLIO" are based on the composite as well.

Mr. Valicenti set two overall goals for creating the VAS performance materials: (i) that the performance results be representaive of the performance of the firm; and (ii) that the selected composite of accounts have assets representing 20% to 25% of the assets under management. (Tr. 835-36, 846, 856-58, 894; see Resp. Ex. 16.) Additionally, Mr. Valicenti stated that VAS had always been risk averse and that he wanted to approach an asset mix of 50%/50% stocks and bonds. (Tr. 856-57.) The criteria Mr. Valicenti used for choosing accounts for the composite, and meeting these overall goals, were articulated somewhat differently at different times. Additionally, there was a confusion between "accounts with a balanced objective" (where "balanced" refers to the client's objective) and "balanced accounts" (where "balanced" refers to the asset mix of equities and fixed income securities). (Compare, e.g., Tr. 485-86, with Tr. 487.) The criteria included that: (i) the account have over $100,000 in assets; (ii) the account be fully discretionary; in other words that there were no restrictions placed on the account by the client or that there were no holdings in the account which made it less than fully discretionary; (iii) the account be included for the five year period represented on the composite; and (iv) the investment goals of the account be both income and capital appreciation. (Tr. 534-38; 837-39; see 844-57, 879-80; Div. Ex. 61.)

Mr. Valicenti believed that the composite of accounts underlying the 1991 Chart (the 1991 composite) was representative of the VAS accounts under management. (Tr. 865-66.) Mr. Valicenti explained in detail the reasons, unrelated to performance, that he included and excluded accounts from the composite. (Tr. 844-55, 959-60.) At the time he selected the 22 accounts that were circled to be used in the 1991 composite, he was not aware of the rate of return that any of the accounts had earned over the previous five years. (Tr. 847.) His testimony to this effect is credible because the rates of return had to be computed from data extracted manually from paper copies of archived client reports; the data was not available on VAS' computer system. (Tr. 157, 515, 735-38.) Therefore, the evidence does not show that Mr. Valicenti "cherry-picked" the

best performing of the 500 accounts under management to comprise the composite.

A client with a mixture of income and growth as an investment objective could be broadly described as having a balanced investment objective, according to Mr. Valicenti. (Tr. 485.) Prior to the investigation Mr. Valicenti had never written down his definition of a balanced account. (Tr. 841.) He testified that a balanced account had to have some mixture of stocks and bonds, not more than 70% of either, with some exceptions to the rule; he considers a 70%-30% split as a guideline. (Tr. 487-91, 841-42; see Div. Ex. 61.)[14]

Some of the accounts in the 1991 composite do not meet Mr. Valicenti's critera.[15] (Tr. 880-81; see also Tr. 899-900; Div. Ex. 61.) Mr. Valicenti knew, or would have known had he reviewed Mr. Marchese's work carefully, that the composite did not contain data for all of the selected accounts for all five years. (Tr. 882-86.) There were other balanced accounts at VAS that were not included in the composite. (Tr. 519; Div. Ex. 9.) Some of the accounts included in the composite were not balanced as defined by Mr. Valicenti. (Div. Ex. 9.) It was Mr. Valicenti's intent to lump all of the accounts in the composite together and have the group of accounts, as a whole, fit into the 70/30 balanced definition. (Tr. 528-29.)

The evidence described above shows that Mr. Valicenti intended to have a composite that was representative of accounts under management but that he did not decide on precise criteria in advance and follow them strictly in choosing the accounts. He had criteria but applied them flexibly to achieve his goal of a composite that was representative.

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[14] Mr. Valicenti considered preferred stock a "fixed income asset," and included the Ziff account in the composite, even though it contained no bonds, because it contained a ratio of approximately 70% common stock to 30% preferred stock. (Tr. 901-02, 912-13.) See DOWNES & GOODMAN, supra note 12, at 195.

[15] For example, the Benedictine Foundation of New York and James E. Collins accounts did not exist at VAS for the full five year period. (Tr. 880-81.)

Dr. Gartrell gave opinion testimony concerning the methods by which VAS chose the accounts included in the composite. (Tr. 921.) He opined that the selection criteria were fair and reasonable. (Tr. 959-62.)

The 1991 Chart

At the start of the project Mr. Valicenti showed Mr. Marchese how to calculate quarterly returns and provided him with material produced by the American Institute of Management Research (AIMR), an industry group; Mr. Marchese also studied other books and materials concerning calculating rates of return. (Tr. 158, 257-61; see also Tr. 317; Div. Ex. 40.) After pulling the files for the 22 accounts, Mr. Marchese undertook a three-step process in calculating the rates of return for those accounts: (i) he took handwritten notes of data from the files; (ii) he formatted the data so that he could enter the information into VAS' "Portia" computer system; and (iii) he entered the information into Portia and calculated rates of return. (Tr. 157-58, 165-74; Div. Ex. 103.) Mr. Marchese then inputted the Portia results into a spreadsheet to calculate the annual rates of return used in the 1991 Chart and the 1991 Bar Graph. (Tr. 174-81; Div. Exs. 42, 43, 44; see also Tr. 233-35; Div. Ex. 48.)

Mr. Marchese generated interim spreadsheets with results that were not used in creating the 1991 Chart. (Tr. 187-88, 195; see, e.g., Div. Exs. 26, 27, 28, 29.) These interim runs excluded or added accounts, or excluded or added information regarding an account.[16] (Tr. 187-97, 318-22; compare Div. Exs. 42, 43, 44, with Div. Exs. 26, 27, 28, and Div. Ex. 29.) Mr. Marchese created these different versions at the direction of Mr. Valicenti. (Tr. 187-97.) Mr. Valicenti reviewed Mr. Marchese's worksheets and decided which performance results would be used in the presentation materials. (Tr. 159, 177, 519; see Div. Ex. 42, 43, 44.)

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[16] The account mix for all these runs contained combinations of the original 22 accounts. No new accounts were added. (Tr. 187-97, 275-80, 318-22; compare Div. Exs. 42, 43, 44, with Div. Exs. 26, 27, 28, and Div. Ex. 29.)

Three of the original 22 circled accounts were not included at all on the final spreadsheet used to create the 1991 Chart: Chemung County Historical Endowment, Jean B. Shull, and Josephine Ambrose. (Tr. 183-87, 275-80, 318-22, 859-60; Div. Exs. 25, 42, 43, 44.) Mr. Valicenti excluded those accounts because they did not meet his selection criteria. (Tr. 859-60.) Several accounts that were included in the spreadsheet did not have data for all five years.[17] (Tr. 183-87; Div. Exs. 42, 43, 44.) Mr. Valicenti testified that he did not tell Mr. Marchese to eliminate any accounts because of the poor rates of return the accounts had earned. (Tr. 859.) The record does not show that Mr. Valicenti systematically tested the effect on the total rate of return of including or excluding each individual account of the 22. (Tr. 294-95.) During the process of creating the chart, however, he would have become aware of the effect on the performance calculations of those that were included or eliminated in the interim spreadsheets.[18]

After calculating the final performance numbers, (see Div. Exs. 42, 43, 44), Mr. Valicenti directed Mr. Marchese to analyze the information to determine the percentage of equities and bonds in the accounts and in the composite. (Tr. 197-98, 498-99; Div. Ex. 51.) Mr. Valicenti then asked Mr. Marchese to create a model to present the information, but he rejected all of Mr. Marchese's suggestions.[19] (Tr. 199-202, 317, 513-14; see Div. Exs. 32, 40, 100.) Finally, Mr. Marchese prepared the 1991 Chart after Mr. Valicenti provided him with an example of how

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[17] The result, therefore, was that performance represented in the 1991 Chart and the 1991 Bar Graph was based on nineteen accounts for 1991, 1990, and 1989; seventeen accounts for 1988; and 13 accounts for 1987. (Tr. 882-83; Div. Ex. 39.)

[18] Division Exhibit 29 contains Mr. Valicenti's handwriting which shows that he was trying to get a feel for what the five year return was on this run. (Tr. 196-97; Div. Ex. 29.)

[19] Mr. Marchese's rejected models provided more disclosure and included more information than the 1991 Chart and the 1991 Bar Graph. (Tr. 199-202, 204-05, 317; compare Div. Exs. 3, 5A, with Div. Exs. 32, 40, 100.)

he wanted the performance results to be presented. (Tr. 202-03, 513-14, 861.)

The 1991 Bar Graph

The 1991 Bar Graph depicted the five year rate of return numbers from the chart against a benchmark that was based on a sample of money managers. (Tr. 214-18, 492.) Mr. Valicenti instructed Mr. Marchese to order, from CDA Investment Technologies, Inc. (CDA), data that showed industry performance results for accounts with a ratio of 50% equities to 50% bonds (the CDA Universe). (Tr. 218-20, 492, 497.) Mr. Marchese then prepared the 1991 Bar Graph, plotting VAS' performance against the selected industry group. (Tr. 214-15, 491-94.) The five year rate of return numbers from the 1991 Chart were indicated by asterisks placed in reference to three column reflecting the CDA information.[20]

Over the five year period, however, equities comprised 54.4%, not 50%, of VAS' total asset mix.[21] (Tr. 220-22, 505-08; Div. Exs. 40, 51.) Division Exhibit 51 shows that equities were 54.4%, bonds were 38.6%, and the remainder was cash/other, so that the ratio of equities to bonds, without including cash/other, was approximately 58.5% to 41.5%. Cash could, however, have been attached to bonds in the calculations. (Tr. 346.) It was therefore reasonable for VAS and Mr. Valicenti to assume the composite had 54.4% equities. When a customer orders data from CDA, CDA asks for the desired percentage of equities; it

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[20] The 14.27% return for VAS' "TOTAL PORTFOLIO" result from the 1991 Chart is indicated on the 1991 Bar Graph with an asterisk in a column titled "BAL. 50%EQ./50%BDS." (Tr. 217, 491-94; Div. Exs. 3, 5A.) The 18.20% return for VAS' "EQUITY PORTFOLIO" result from the 1991 Chart is indicated on the 1991 Bar Graph with an asterisk in a column titled "EQUITY." (Tr. 217-18, 493-94; Div. Exs. 3, 5A.) The 10.17% return for VAS' "BOND PORTFOLIO" result from the 1991 Chart is indicated on the 1991 Bar Graph with an asterisk in a column titled "FIXED INCOME." (Tr. 217, 494; Div. Exs. 3, 5A.)

[21] Division Exhibits 40 and 51 show that the percentage of equity assets in the composite for each year was: 1987, 51%; 1988, 53%; 1989, 61%; 1990, 49%; and 1991, 58%.

does not ask for a percentage of fixed income. (Tr. 761-64.) Mr. Valicenti knew that CDA would supply information for other than 50/50, but he did not know the increments. (Tr. 510-12).

Mr. Valicenti stated that 50/50 is the norm in the banking industry, where he had spent the first 16 years of his career. (Tr. 500.) He testified that he chose 50/50 because 50/50 connotes balance, because VAS is risk averse, and for five years of VAS' performance, 50/50 was appropriate. (Tr. 222, 861-64; Div. Exs. 40, 51.) He took a quick average of the composite's equity percentages for the five years when he asked Mr. Marchese to order 50/50; he did not make a careful calculation. (Tr. 503-05.) Mr. Valicenti acknowledged at the hearing that the VAS asterisk on the 1991 Bar Graph did not represent the performance of a composite that had a ratio of 50% equities to 50% bonds, but still believed the fifty-fifty ratio was a proper measurement of comparison. (Tr. 497-99, 862-64; see also Tr. 220-22; Div. Exs. 40, 51.) The evidence above shows that Mr. Valicenti chose the 50/50 benchmark in good faith based on the VAS composite's containing 54% equities. However, more painstaking review and inquiry would have led him to consider the proportion of bonds, the allocation of cash and the availability of varying increments, specifically between 50/50 and 60/40, from CDA.

The 1991 Bar Graph suggested that, when compared to a universe of similar money managers, VAS was ranked in the top 5% as a manager of accounts with a ratio of 50% equities to 50% bonds and ranked highly as a manager of equities and of fixed income. (Tr. 222-23; Div. Ex. 5A.) From 1987 through 1991, equities in the VAS composite outperformed bonds and, therefore, the more equities in a composite the better the composite would be expected to perform; thus comparing a composite with 54.4% (and a fortiori 58.5%) equities against a benchmark of 50% equities would cause the composite to appear somewhat better than it really was. (Tr. 496-97.)

Mr. Marchese also prepared a bar graph that compared VAS' one, three, and five year performance with a CDA Universe representing a "BALANCED PORTFOLIO: 60% EQUITY." (Tr. 224, 864-65; Div. Ex. 30; see also Tr. 234-35; Div. Ex. 48A.) That

graph showed that VAS performance for the five year period was ranked highly, but below the fifth percentile threshold of 15.6% return. (Tr. 228-30; Div. Ex. 30.) Mr. Valicenti showed this bar graph to at least one prospective client. (Tr. 510, 864-65, 894; Div. Ex. 30.)

Mr. J. Valicenti's Subsequent Performance Calculations

During the course of the Commission investigation of VAS, Mr. J. Valicenti prepared a document that showed rates of return for the accounts making up the 1991 composite. (Tr. 731-32; Div. Ex. 90.) The calculations in this document excluded the Maria Kaufman account because Ms. Kaufman died in that year. (Tr. 732, 734; Div. Ex. 90.) In addition, Mr. J. Valicenti used equally-weighted rates of return as opposed to the market-weighted rates of return used to create the 1991 chart.[22] (Tr. 732-34; Div. Ex. 90.) The results on Mr. J. Valicenti's document, therefore, are not strictly comparable with those reported on the 1991 Chart. (Tr. 733-34; compare Div. Ex. 90, with Div. Ex. 3.)

Mr. J. Valicenti also calculated 1987 through 1991 rates of return for the nineteen accounts selected for use in the 1991 Chart.[23] (Tr. 749-52; Resp. Ex. 21A.) As a result of adding 1987 data for the four accounts omitted from Mr. Marchese's calculations, the five year rate of return decreased from 14.27% to approximately 14.05%. (Tr. 749-50; compare Div. Ex. 3, with

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[22] A market-weighted rate of return takes into consideration the size of an individual portfolio in relation to the total of all portfolios. A market-weighted rate of return is calculated by "taking the percentage of the total of the individual portfolio, divided by the total of all the portfolios in the group, and multiplying that across the rate of return." (Tr. 733.) An equal-weighted rate of return represents the return of the portfolio calculated with "the same percentage of weighting . . . [r]egardless of market size." (Tr. 733.)

[23] Mr. J. Valicenti included in his calculations 1987 data for four accounts, Andrew J. Dozack, Jr., Ida S. Fidelman, Gilbert Meltzer, and Herbert M. Ziff, Inc., that were left out of Mr. Marchese's calculations. Mr. J. Valicenti did not include 1987 and 1988 data for two accounts, the Benedictine Foundation of New York and James E. Collins, because they were opened in mid-1988. (Tr. 749-52; Resp. Ex. 21A.)

Resp. Ex. 21A.) As a result of adding 1987 data for the four accounts omitted from Mr. Marchese's calculations and correcting certain mathematical errors, the five year rate of return decreased from 14.27% to approximately 13.56%. (Tr. 751-52; compare Div. Ex. 3, with Resp. Ex. 21A.)

Mr. J. Valicenti also calculated 1987 through 1991 rates of return for the original 22 accounts selected for use in the 1991 Chart.[24] (Tr. 741-49; Resp. Ex. 47A.) As a result of adding the three accounts omitted from Mr. Marchese's calculations, the five year rate of return decreased from 14.27% to approximately 13.76%. (Tr. 744-45; compare Div. Ex. 3, with Resp. Ex. 47A.) As a result of adding the three accounts omitted from Mr. Marchese's calculations and correcting certain mathematical errors, the five year rate of return decreased from 14.27% to approximately 13.26%. (Tr. 746-49; compare Div. Ex. 3, with Resp. Ex. 47A.)

Mr. J. Valicenti ordered from CDA a printout showing the performance of money managers from 1987 through 1991 using the same criteria used in creating the 1991 Bar Graph except that the asset mix selected was 54.6% equities and 45.4% fixed income. (Tr. 761-71; Resp. Ex. 34.) The results show the top fifth percentile of performance at 14.2% and above, the top tenth percentile at 13.3% and above, and the top twenty-fifth percentile at 12.5% and above. (Tr. 768-69; Resp. Ex. 34.)

The record does not show that the Commission compliance examiners or the Division calculated rates of return from VAS' records of accounts.

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[24] Mr. J. Valicenti included in his calculations the three accounts left out of the 1991 Chart calculations, Chemung County Historical Endowment, Jean B. Shull, and Josephine Ambrose, but did not include 1987 and 1988 data for two accounts, the Benedictine Foundation of New York and James E. Collins, because they were opened in mid-1988. (Tr. 742-43, 750-51; Resp. Ex. 47A.)

Distribution

VAS distributed the 1991 Chart and the 1991 Bar Graph in the blue folders to prospective clients on a number of occasions during 1992, mostly during or after a meeting with the prospects. Mr. Valicenti testified that in 1992 VAS handed out copies at presentations to the Chemung County Community Foundation, the Soaring Museum. St. Joseph's Hospital, and the Woodbrook adult care facility. (Tr. 866-68.) Additionally, he furnished them to about 8-10 individuals with whom he met.[25] (Tr. 868, 905-06, 913-15.) Mr. Marchese testified that he provided the performance material to four individuals whom he identified; there may have been a few other individuals to whom he provided the materials, as well. (Tr. 298-301.) He also testified that blue folders were available at the opening of the Corning office and that he would have handed some out to people who requested information; he assumed that folders contained the 1991 Chart and the 1991 Bar Graph but did not recall whether he discussed the performance materials with anyone there. (Tr. 317-18, 322-23.) Ms. Rogers testified that, at the behest of Mr. Valicenti or a portfolio manager, she mailed "maybe between 20 and 100" blue folders containing performance information. (Tr. 131.) Mr. Reidy's general testimony was in accord with this. (Tr. 437-39.)

The Division suggests that the distribution of the 1991 Chart and 1991 Bar Graph resulted in an increase in the number of accounts and assets under management at VAS in 1992. (Div. Reply to Resp. Proposed Findings of Fact at 4.) VAS' business continued to grow during 1992. (Div. Ex. 9; Tr. 467-68, 520.) There is, however, no evidence to connect the growth to the limited distribution of the performance materials. There is no evidence to show that the 1991 Chart and 1991 Bar Graph were decisive factors in acquiring clients. There is not a scintilla of evidence to suggest that any client or prospective client relied on

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[25] Additionally Mr. Valicenti acknowledged that he had mailed the materials in 1992 to an individual who never met with him or became a client. (Tr. 907-08, 914; Div. Ex. 115.)

the materials, much less suffered any losses, or that VAS or Mr. Valicenti profited from the use of the materials.

EXPERT TESTIMONY

The Commission's rules do not specify requirements for performance standards for investment advisers, thus testimony from several expert witnesses was received, bearing on standards and practices in the industry, as well as other matters. In its direct case the Division offered Robert L. Hagin, Ph.D., a partner since 1985 in Miller, Anderson, Sherrerd, an investment adviser to large institutional clients with a minimum account size of $25 million. (Tr. 333-35.) He was offered as an expert concerning the normal practices and ordinary standards of care in the presentation of performance material and how prospective clients use investment adviser performance material. (Tr. 336-37.)

In response to Dr. Hagin's testimony, Respondents offered Jeffrey P. Lessard, Ph.D., Associate Professor of Finance and Accounting at Rochester Institute of Technology as an expert in investment management industry standards and practices for performance presentation and on what a reasonable investor would consider material. (Resp. Ex. 74 at 2-3; Apr. Tr. 10-96.) Respondents also offered, in response to Dr. Hagin, John W. Piccione, a portfolio manager at Chase Manhattan Bank in Rochester, as an expert concerning investment management industry practices and standards. (Resp. Ex. 75 at 2-5; Apr. Tr. 98-139.) In rebuttal, the Division offered Scott Lummer, Ph.D., currently employed by Ibbotson Associates, a consulting and data products firm, as an expert concerning widely recognized principles in the investment adviser industry in the presentation of performance data using composites. (Tr. 145-52; Div. Ex. 116.)

Procedural Issues

The Division, by oral motions, challenged the qualifications of Dr. Lessard and Mr. Piccione to testify as experts. I took the Division's motions under advisement at the hearing.

After extensive voir dire focusing on Dr. Lessard's curriculum vitae, the Division moved that he not be received as an expert qualified to render an opinion in this matter on the basis that his background and experience do not include first hand knowledge or academic knowledge that bears on the facts in dispute. (Apr. Tr. 13-46; Resp. Ex. 71.) The motion will be denied, and Dr. Lessard accepted as an expert. His present teaching, research, and administrative activities include performance standards and other practices in the investment management industry. (Tr. 68-76; Resp. Ex. 70 at 3-7.)

After voir dire focusing on Mr. Piccione's curriculum vitae, the Division moved that he not be received as an expert qualified to render an opinion in this matter on the basis that his job does not include producing advertising material, which is the subject of this case. (Apr. Tr. 99-115; Resp. Ex. 76.) The motion will be denied, and Mr. Piccione accepted as an expert. His employment is in an occupation similar to that of an investment adviser and his professional activities include performance presentation and other practices in the investment management industry. (Tr. 130-33; Resp. Ex. 75 at 2-5.)

Performance Presentation Standards

Division expert Hagin testified that VAS' performance materials violated a number of well known "rules of the road" that were later codified in AIMR's Performance Presentation Standards.[26] For example, he testified that VAS' use of a "composite" based on some but not all of its accounts was never appropriate. (Tr. 391.) Similarly violative of the "rules of the road" was VAS' use of end of period market values[27] in its

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[26] The AIMR standards were published in 1993. (Tr. 607-09; Resp. Ex. 74 at 9.) Although the Division stressed repeatedly that this proceeding is not based on AIMR standards, (Tr. 609, 619; Apr. Tr. 198), Dr. Hagin referred to them frequently. (see, e.g., Tr. 377, 609-10, 626.)

[27] In contrast to the extensive evidence in the record concerning the selection of accounts used for the composite, there is essentially no evidence on why end of period values were used. There is only a glancing reference at Tr. 158.

calculations, which was "sloppy work," according to Dr. Hagin. (Tr. 347-50.) On the other hand, VAS used market weighting and geometric linking to calculate the performance of the accounts used in the 1991 Chart, which he considered appropriate. (Tr. 342-43, 613.) Concerning the CDA universe, Dr. Hagin opined that normal convention in the industry was to use 60/40, and observed that the 1991 Bar Graph showing 50/50 disclosed that VAS "picked a slower rabbit to run against." (Tr. 407-08.) Dr. Lessard opined that VAS' use of the 50/50 benchmark was appropriate. (Resp. Ex. 74 at 28.)

Dr. Lessard articulated what is, it must be concluded, the most accurate overview: the "only standard in the industry . . . [is] the standard that has grown out of cases . . . before the Securities and Exchange Commission . . . . [It] is fair disclosure, [no] materially misleading information, no deceit, no fraud intended in the presentation of performance information." (Apr. Tr. 73, 233.) Dr. Lessard contrasted the situation of investment advisers with that of accountants, for whom recognized standards do exist and are enforced; indeed, if an investment adviser wanted to learn how to present the performance in the appropriate manner, he would be frustrated by the lack of universal standards. (Resp. Ex. 74 at 8-22; Apr. Tr. 233-36; see also, Dr. Hagin's testimony at Tr. 617-19, 625.)

Reasonable Investor's Understanding of "Composite"

The phrase "Composite of discretionary accounts with a balanced objective" appears on the 1991 Chart. (Div. Ex. 3.) Respondent expert Lessard testified that "composite" has no clear meaning to the average investor. (Resp. Ex. 74 at 23.) Dr. Hagin commented that it has an explicit meaning to someone in the investment adviser industry, i.e., no sampling and no selectivity, but that someone not in the industry may now know the importance or meaning of the statement. (Tr. 614-15.) Dr. Lummer also testified that the meaning of "composite" (i.e., to include all accounts under management) would be completely unambiguous to those in the investment management community but may not be as clear to the average investor. (Apr. Tr. 209-11.)

Materiality of Performance Information

Respondent Valicenti testified that personal service for individuals seeking someone to handle their financial affairs attracts clients to VAS, while conceding that performance is a leveling factor; he stated that most prospects do not talk about performance or request performance information. (Tr. 843-44.) According to Division expert Hagin, performance, alone, is crucial in attracting clients; "handholding" is taken for granted. (Tr. 383-84, 636-37.)

THE 1992 CHART AND 1992 BAR GRAPH

In January 1993, when Mr. Marchese resigned from the firm, Mr. Valicenti told Mr. Reidy to update the VAS performance materials. (Tr. 428, 443, 870-71.) Mr. Reidy began compiling 1992 performance figures for the accounts represented on the 1991 Chart. (Tr. 430.) Mr. Valicenti told Mr. Reidy that the figures were not correct and that some accounts should be excluded. (Tr. 430-31, 871-72.) Mr. Valicenti gave Mr. Reidy a new list of twenty-eight accounts to work with, which included thirteen, but excluded six, of the accounts used in the 1991 Chart. (Tr. 431-32, 443, 450-51, 871-72; see Div. Ex. 39.) In addition, one of the three original accounts left off of the 1991 composite, Chemung County Historicial Endowment, was included in the 1992 composite. (See Div. Ex. 39.) In approximately March 1993, Mr. Reidy created the new chart (the 1992 Chart) and bar graph (the 1992 Bar Graph) showing VAS performance for 1988 through 1992. (Tr. 429-34; Div. Exs. 4, 6A.)

There is conflicting evidence on whether the new materials were distributed. Weighing the evidence in light of the Division's burden of proof, I find that the Division failed to show by a preponderance of the evidence that the new materials were distributed.

Mr. Valicenti testified that to his knowledge VAS never distributed the updated material, stating that he put the project on the back burner because he had noted some problems with it, and VAS had no need to make a presentation to bid for an

institution's business. (Tr. 869, 872-73.) Mr. J. Valicenti testified that he was unaware of the existence of the updated material prior to the Commission examination in December 1993; as a portfolio manager, he would have known of the material if it was completed and in use. (Tr. 724-26.) Nor did VAS employees Diana Rockwell or Nancy Lehman recall the updated material ever being distributed. (Tr. 673-74, 691.)

Lawrence Cutler, a Commission compliance examiner who conducted the December 1993 examination at VAS, testified that Mr. Valicenti included the updated materials with documents he provided in response to Mr. Cutler's request for performance materials shown to clients. (Tr. 18-19, 21, 23-24.) This indicates Mr. Valicenti's full cooperation with the examination. His testimony that the updated materials were not distributed, however, weakens the Division's argument that his providing them to Mr. Cutler implies that they were distributed.

Ms. Rogers could only recall charts and bar graphs generally, not the 1992 versions, specifically, as being included in the folders. (Tr. 126-30, 146.) David Reidy stated generally that the updated material was sent to prospective clients. (Tr. 433-36.) However, when asked to identify any clients to whom he sent the updated material, he could only recall one, Frank Fisher; he could not recollect when he sent the material to Mr. Fisher, but did recall that Mr. Fisher met with him thereafter and became a client. (Tr. 441-42, 444-45.) Mr. Fisher, however, had become a client during 1992, before the updated material was created.[28] (Tr. 869; Div. Ex. 9.) The fact that Mr. Reidy's recollection, which was at best vague, concerning the material

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[28] The Division argues in its Reply Brief at 31-32 that Mr. Fisher was an existing client when he was sent the material, citing approvingly to Mr. Reidy's testimony at Tr. 441 that he sent the material to Mr. Fisher, but overlooking his testimony at Tr. 442 that Mr. Fisher thereafter met with him and became a client. The Division argues unconvincingly that this corroborates its reasoning concerning distribution of the updated materials based on Mr. Cutler's testimony that they were included among documents provided in response to his request for performance materials shown to clients.

provided to Mr. Fisher was inconsistent with more reliable evidence in the record undercuts, as well, his general recollection that the updated material was sent out to individuals whom he could not identify.

The testimony of Ms. Rogers and Mr. Reidy was not probative evidence that the 1992 materials were distributed. Mr. Valicenti, as is amply demonstrated throughout the record, was very much in control at VAS, and his testimony that the materials were not distributed, placed in context, is more credible. Additionally, the Division has the burden of proof by a preponderance of the evidence. In sum, the record does not contain a preponderance of evidence to establish that the updated materials, the 1992 Chart and the 1992 Bar Graph, were ever distributed.

III. CONCLUSIONS OF LAW

The OIP alleges that VAS willfully violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rules 206(4)-1(a)(2) and 206(4)-1(a)(5) thereunder, and that Mr. Valicenti willfully aided and abetted the violations. The record supports a conclusion that VAS willfully violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) in connection with the 1991 Chart and 1991 Bar Graph, and that Mr. Valicenti was "a cause of the violation" within the meaning of Section 203(k)(1) of the Advisers Act. The alleged violation of those sections in connection with the 1992 Chart and 1992 Bar Graph was not proven. The alleged violation of Advisers Act Section 206(4) and Rules 206(4)-1(a)(2) and 206(4)-1(a)(5) in connection with the M.R. Sample was not proven. Finally, it is concluded that Mr. Valicenti did not aid and abet VAS' proven violations within the meaning of Sections 203(e) and 203(f) of the Advisers Act.

SECTIONS 206(1) AND 206(2) OF THE ADVISERS ACT

Under Sections 206(1) and 206(2) of the Advisers Act, it is unlawful for an investment adviser to employ any device, scheme, or artifice to defraud, or to engage in any course of business, that operates as a fraud on clients or prospective

clients. These sections prohibit investment advisers from making material misrepresentations to clients or prospective clients. A violation under Section 206(1) requires scienter, a knowing or reckless disregard for the truth. SEC v. Steadman, 967 F.2d 636, 641-42 (D.C. Cir. 1992). Scienter is not a required element of a Section 206(2) violation; a finding of negligence is adequate. Id. At 643 & n.5 (citing SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963)).

1992 Chart and 1992 Bar Graph

No violations were established concerning the 1992 Chart and 1992 Bar Graph. They were not distributed to any client or prospective client.

1991 Chart and 1991 Bar Graph

VAS and Mr. Valicenti distributed the 1991 Chart and 1991 Bar Graph to several prospective clients.

No violations were established concerning misrepresentation of VAS' performance, i.e., its rate of return. The Division failed to demonstrate what was a fair representation of VAS' performance during the relevant period; nor can a fair representation be calculated from any record evidence.[29] While many calculations were presented and compared with VAS' performance materials, none were proven correct or accurate. The expert testimony made clear that, at the time VAS created and distributed its charts and graphs, there was no universally accepted industry standard for calculating and presenting performance results of investment advisers. There are conflicting opinions on definitions, methodologies, and conclusions. In addition, the Commission has provided little guidance on the appropriate methods for calculating and presenting performance.

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[29] The Division's suggestion, in its Reply Memorandum at 33, that it does not have to prove what a fair representation should have been is inconsistent with its burden of proving a violation of the statute by a preponderance of the evidence. See Steadman v. SEC, 450 U.S. 91, 102 (1980).

There is, however, misrepresentation of matters other than VAS' rate of return.

a. Misrepresentation

The 1991 composite did not include all the accounts for the full five year period although, after reading the 1991 Chart, a client or prospective client could have reasonable assumed that was the case. The record shows that this inaccuracy resulted from negligent acts or omissions of Mr. Valicenti and VAS.

Additionally, the manner in which the results on the 1991 Chart were presented on the 1991 Bar Graph portrays to investors certain information that is not precisely accurate. The total portfolio results on the 1991 Chart were, supposedly, calculated from a composite of accounts with a balanced objective over a five year period. The 1991 Bar Graph compared those results to an industry sample of accounts with 50% equities and 50% bonds. A client or prospective client, after reviewing the 1991 Chart and 1991 Bar Graph, could have reasonably assumed, therefore, that the VAS accounts reflected on the 1991 Chart were accounts with 50% equities and 50% bonds. The VAS performance asterisk on the 1991 Bar Graph, however, did not represent the performance of a composite that had a ratio of 50% equities to 50% bonds. In fact the composite had approximately 54% equities. The performance asterisks, therefore, do not accurately depict the performance of the VAS composite against a comparable industry standard. The record shows that this inaccuracy resulted from negligent acts or omissions of Mr. Valicenti and VAS.

b. Materiality

While performance is clearly material, misrepresentation of performance was not proven. Whether the misrepresentation that was proven is material is a closer question. The standard of materiality is whether or not a reasonable client or prospective client would have considered the information important in deciding whether or not to invest with VAS and Mr. Valicenti. See SEC v. Steadman, 967 F.2d at 643; see also Basic Inc. v. Levinson, 485 U.S. 224, 240 (1988); TSC Industries, Inc. v.

Northway, Inc., 426 U.S. 438, 449 (1976). On balance, it is concluded that the fact of VAS' misrepresentation would be considered important information to a reasonable client or prospective client. A client would consider accurate accounting of his assets to be important and VAS' errors and omissions might suggest slipshod accounting in client accounts.

c. Section 206(2) Violations

Therefore, VAS violated Section 206(2) because it negligently misrepresented, to clients and prospective clients, material facts about VAS' performance in the 1991 Chart and 1991 Bar Graph.

d. Willful Violations

This proceeding was instituted pursuant to Advisers Act Sections 203(3), 203(f) and 203(k). The Commission must find willful violations to impose sanctions under Sections 203(e) and 203(f). The question arises whether the violations in this case, which resulted from negligent conduct, are "willful" within the meaning of Sections 203(e) and 203(f). Footnotes are not the best source of authoritative rulings on a dispositive question. See McElroy Electronics Corp. v. FCC, 990 F.2d 1351 (D.C. Cir. 1993); RCA Global Communications, Inc. v. FCC, 758 F.2d 722 (D.C. Cir. 1985). However, the Commission's rulings on this issue appear in such sources.

The Commission has ruled that negligence based violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933, comparable to Advisers Act Sections 206(2) and 206(4), were "willful." C. James Padgett, SEC Docket 319, 331 n.34 (1997), appeal pending. The Commission stated, without elaboration, that:

> [respondents]argue that negligent conduct cannot support a finding of "willful" conduct. Section 15(b) of the Exchange Act, under which this proceeding was brought, requires a finding of a violation of the securities laws to be "willful." The courts have long held that willfulness here means no more than intentionally committing the act that constitutes the violation.

Id. (citing Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (1976), cert. Denied, 434 U.S. 1009 (1978)); see also, First Pittsburgh Securities Corp., 47 S.E.C. 299, 304 n.19 (1980); Donald T. Sheldon, 51 S.E.C. 59, 82 n. 94 (1992), aff'd on other grounds, 45 F.3d 1515 (11th Cir. 1995). Thus, willfulness derives from the discrete acts and omissions that form the negligent conduct, in this case the preparation of the performance materials that were distributed by the Respondents. Accordingly, it is concluded that the villations in this case are willful within the meaning of Advisers Act Sections 203(e) and 203(f).

VAS committed its violations largely through the acts and omissions of Mr. Valicenti, as set forth above. Thus, Mr. Valicenti was a "cause" of VAS' violations within the meaning of Section 203(k)(1) of the Advisers Act because of acts or omissions he "knew or should have known would contribute to such violation."

e. Aiding and Abetting

Whether Mr. Valicenti aided and abetted VAS' violations within the meaning of Advisers Act Sections 203(e) and 203(f) is a different question. For aiding and Abetting violations of the federal Securities laws, three elements must be present: i) a primary or independent securities law violation that has been committed by some other party; ii) awareness or knowledge by the aider and abettor that his or her role was part of an overall activity that was improper; and iii) that the aider and abettor knowingly and substantially assisted the conduct that constitutes the violation. Woods v. Barnett Bank of Fort Lauderdale, 765 F.2d 1004, 1009 (11th Cir. 1985); Investors Research v. SEC, 628 F.2d 168, 178 (D.C. Cir.), cert. Denied, 449 U.S. 919 (1980); IIT v. Cornfield, 619 F.2d 909, 922 (2d Cir. 1980); Woodward v. Metro Bank of Dallas, 522 F.2d 84, 94-97 (5th Cir. 1975); SEC v. Coffey, 493 F.2d 1304, 1316 (6 th Cir. 1974), cert. Denied, 420 U.S. 908 (1975); William R. Carter, 47 S.E.C. 471, 502-03 (1981).

The first and third elements, that a primary violation was committed by VAS and that Mr. Valicenti knowingly and substantially assisted the conduct that constitutes the violation are clearly present. The second element, awareness or knowledge that his role was part of an overall activity that was improper, is, however, absent. The knowledge or awareness requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or active participant. See Ross v. Bolton, 904 F.2d 819, 824 (2d Cir. 1990); Cornfield, 619 F.2d at 923, 925; Rolf v. Blythe, Eastman Dillon & Co., 570 F.2d 38, 47-48 (2d Cir.), cert. Denied, 439 U.S. 1039 (1978); Woodward, 522 F.2d at 97. Neither the courts nor the Commission have, however, ruled that negligence is sufficient.[30] Accordingly, it is concluded that Mr. Valicenti did not aid and abet VAS' violations of Section 206(2).[31]

f. Section 206(1)

Neither VAS nor Mr. Valicenti knowingly or recklessly misrepresented VAS' performance in the 1991 Chart and 1991 Bar Graph, and, therefore, there is no violation of Section 206(1). Likewise, without a primary violation, there is no aiding and abetting violation of Section 206(1). Mr. Valicenti did not select performance figures that he knew were false in order to induce his clients or prospective clients to invest with him, or to otherwise defraud any client or prospective client. Nor were VAS' or Mr. Valicenti's actions reckless — "an extreme departure from the standards of ordinary care." SEC v. Steadman, 967 F.2d at 641-42 (quoting Sundstrand Corp. v.

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[30] The Commission has made Delphic statements in footnotes that could be construed as implying that negligence is sufficient. See Raymond L. Dirks, 47 S.E.C. 434, 448 n.51 (1981), aff'd, 681 F.2d 824 (1982), rev'd on other grounds, 463 U.S. 646 (1983); Kingsley, Jennison, McNulty & Morse, Inc., 51 S.E.C. 904, 911 n.28 (1993).

[31] The findings of fact herein would support a conclusion that Mr. Valicenti violated Section 206(2). The OIP, however, does not charge him as a primary violator but rather as an aider and abettor of VAS' violations.

Chemical Corp., 533 F.2d 1033, 1045 (7th Cir.), cert. Denied, 434 U.S. 875 (1977)).

SECTION 206(4) OF THE ADVISERS ACT AND RULES 206(4)-1(a)(2) AND 206(4)-1(a)(5)

Section 206(4) prohibits any investment adviser from engaging in any "act, practice or course of business which is fraudulent, deceptive, or manipulative." Rule 206(4)-1(a)(5) makes it illegal for an investment adviser "directly or indirectly, to publish, circulate or distribute any advertisement" which contains any untrue statement of a material fact, or which is otherwise false or misleading." Scienter is not a required element of a violation of Section 206(4). See SEC v. Steadman, 967 F.2d at 647.

Rule 206(4)-1(b) defines "advertisement" to include:

> Any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities.

Material that promotes investment advisory services for the purposes of inducing potential clients to subscribe to these services is an advertisement covered by the rule. SEC v. C.R. Richmond & Co., 565 F.2d 1101, 1105 (9th Cir. 1977) (citing Paul K. Peers, Inc., 42 S.E.C. 539, 540-41 (1965)).

The M. R. Sample

The M.R. Sample is not an advertisement as defined in Rule 206(4)-1(b). The M.R. Sample was intended and used as an example of a VAS client's quarterly account statement. This conclusion is inescapable both from the convincing and

unrebutted testimony concerning its use and from the face of the document. The document is organized to look like an account statement and provides no real useful information other than to demonstrate the components of a VAS account statement. The Division's argument that the document was used to induce clients and prospective clients to subscribe to VAS' services by showing selective past specific recommendations (i.e., mostly securities that had market value higher than cost basis; securities in different industries; and recognizable securities) is strained and unpersuasive compared to the more likely interpretation that it was an example of an account statement. The M.R. Sample does not promote VAS performance or any of VAS' investment services. A reasonable client or prospective client would look upon the M.R. Sample only as an example of an account statement. Therefore VAS did not violate Section 206(4) of the Advisers Act and Rules 206(4)-1(a)(2)[32] and 206(4)-1(a)(5) by distributing the M.R. Sample to clients and prospective clients. Since there is no primary violation, Mr. Valicenti did not aid and

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[32] Rule 206(4)-1(a)(2) makes it illegal for an investment adviser "directly or indirectly, to publish, circulate or distribute any advertisement" which:

> refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person; *provided, however,* that this shall not prohibit an advertisement which sets out or offers to furnish a list of all recommendations made by such investment adviser within the immediately preceding period of not less than one year if such advertisement, and such list if it is furnished separately: (A) state the name of each security recommended, the date and nature of each such recommendation (e.g., whether to buy, sell or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date, and (B) contain the following cautionary legend on the first page thereof in print or type as large as the largest print or type used in the body of the text thereof: "it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list[.]"

abet violations of these provisions with respect to the M.R. Sample.

1992 Chart and 1992 Bar Graph

No violations were established concerning the 1992 Chart and 1992 Bar Graph. They were not distributed to any client or prospective client.

The 1991 Chart and 1991 Bar Graph

The chart and bar graph were used as marketing tools to induce prospective clients to invest through VAS.[33] Thus, VAS' performance charts and bar graphs were advertisements within the meaning of the rule.

The Commission has commented that:

> the use of model or actual results in an advertisement would be false or misleading under Rule 206(4)-1(a)(5) if it implies, or a reader would infer from it, something about the adviser's competence or about future investment results that would not be true had the advertisement included all material facts. Any adviser using such an advertisement must ensure that the advertisement discloses all material facts concerning the model or actual results so as to avoid these unwarranted implications or inferences.

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[33] It is "not improper to judge advertisements of an investment adviser by their impact on the segment of the public at which they were aimed." C.R. Richmond & Co., 565 F.2d at 1106 n.3 (citing Marketline, Inc. v. SEC, 384 F.2d 264 (2d Cir. 1967), cert. denied, 390 U.S. 947 (1968)).

Clover Capital Management, Inc., SEC No-Action Letter, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,378, at 77,183 (Oct. 28, 1986) (citations omitted).[34] VAS violated Section 206(4) and Rule 206(4)-1(a)(5), and Mr. Valicenti caused but did not aid and abet VAS' violations for the reasons discussed above concerning the violations of Section 206(2).

IV. PUBLIC INTEREST

Imposition of administrative sanctions requires consideration of:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). The severity of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); Richard C. Spangler, Inc., 46 S.E.C. 238, 254 n.67 (1976); Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

VAS' and Mr. Valicenti's actions were not egregious. They were negligent in calculating and presenting performance on the documents, but the evidence does not show that Mr. Valicenti

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[34] Whether any communication is, or is not, misleading will depend on all the particular facts, including (i) the form as well as the content of a communication; (ii) the implications or inferences arising out of the communication in its total context; and (iii) the sophistication of the prospective client. Clover Capital Management, Inc., SEC No-Action Letter, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,378, at 77,183 n.3 (Oct. 28, 1986) (citations omitted); Covato/Lipsitz, Inc., SEC No-Action Letter, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,087, at 77,744 (Sept. 23, 1981); Morill Stanfill & Co., (Edward F. O'Keefe), SEC No-Action letter, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,682, at 80,743-44 (March 14, 1978).

intended to fraudulently induce clients and prospective clients to invest with VAS. There is no evidence to suggest that any client or prospective client relied on the materials, much less suffered any losses or that VAS or Mr. Valicenti profited from the use of the performance materials.

The infraction was isolated. There have been no previous disciplinary actions against Respondents. Mr. Valicenti and VAS discontinued the use of the M.R. Sample when questions of its appropriateness were raised. Mr. Valicenti and VAS, otherwise, used the charts and bar graphs in very limited situations. The 1991 Chart and 1991 Bar Graph were distributed in one-on-one meetings and mailed out to prospective clients. The 1992 Chart and 1992 Bar Graph were not distributed, and Mr. Valicenti acknowledged problems with them. This demonstrates Respondents' recognition of potential problems, and sincere attempts to refrain from any inappropriate behavior.

Although VAS and Mr. Valicenti continue to perform investment advisory services, the likelihood for future violations is slim. VAS and Mr. Valicenti have demonstrated, in their actions after the Commission's examination and investigation, that they recognize the potential for problems in performance materials, and that they will continue their business with a heightened awareness. Nevertheless, VAS and Mr. Valicenti failed to take appropriate care in calculating and presenting VAS performance figures and, therefore, caused misleading materials to be distributed to the public.

The Division requests a cease and desist order, civil penalties, and that Respondents be barred from the securities industry. Based on my findings and conclusions, the sanctions the Division seeks are not appropriate in the public interest. In addition, it would be particularly inappropriate to impose such severe sanctions in the absence of clear pronouncements from the Commission regarding the proper methods for calculating and presenting performance data.

Because Mr. Valicenti was a cause of VAS' violations within the meaning of Section 203(k) but did not aid and abet

them within the meaning of Sections 203(e), 203(f), and 203(i), only the cease and desist remedy is available as to him.

REVOCATION

Section 203(e)[35] of the Advisers Act authorizes the Commission to revoke the registration (or take other administrative action) of an investment adviser if it or any associated person willfully violated any provision of the Advisers Act.

The sanctions of revocation and suspension are excessively harsh for the violations in this case. The violations were not egregious, Respondents did not act with scienter, and once they recognized potential problems they discontinued the questionable activities. A sanction of censure is sufficient to recognize the violative conduct and deter such conduct in the future by Respondents and other investment advisers. See Kingsley, Jennison, McNulty & Morse, Inc., 51 S.E.C. 904, 912 (1993). Accordingly, it is in the public interest that Respondent VAS be censured pursuant to Sections 203(e) of the Advisers Act.

CIVIL PENALTIES

Section 203(i) of the Advisers Act authorizes the Commission to impose civil penalties for willfully violating the Advisers Act if it is in the public interest. To the extent that the record contains evidence relevant to the factors enumerated in Section 203(i)(3), it weighs against imposition of a penalty in addition to a censure of VAS. The factors enumerated in Section 203(i)(3)(A) (fraud), (B) (harm to others), (C) (unjust enrichment), and (D) (previous violations) are absent, and (E) (deterrence) is satisfied by the censure. The legislative intent in authorizing the Commission to impose civil penalties was to give it increased flexibility in its choice of remedies, not that it would

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[35] Effective April 9, 1997, Section 203(e)(4) of the Advisers Act was redesignated as Section 203(e)(5), Section 203(e)(5) of the Advisers Act was redesignated as Section 203(e)(6), and Section 203(f) was amended to reflect the changes in numbering.

impose a civil penalty in every case. (H. Rep. 101-616, at 18 (1990); Sen. Rep. 101-337, at 11 (1990).)

CEASE AND DESIST

Section 203(k)(1) of the Advisers Act authorizes the Commission to issue cease and desist orders. If the Commission finds that a person "is violating, has violated, or is about the violate" any provision of the Advisers Act, or rule thereunder, it may enter a cease and desist order against "such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation." Section 203(k)(1).

Neither the Commission nor any court of appeals has ruled on whether the Commission must find a likelihood of future violation to issue a cease and desist order. The courts have, however, ruled that a likelihood of future violation is required when considering the cease and desist authority of other administrative agencies. Precious Metals Assocs., Inc. v. CFTC, 620 F.2d 900, 912 (1st Cir. 1980); Borg-Warner Corp. v. FTC 746 F.2d 108, 110-11 (2d Cir. 1984); NLRB v. Savin Business Machines Corp., 649 F.2d 89, 93 (1st Cir. 1981); Citizens State Bank v. FDIC, 751 F.2d 209, 214-15 & n.9 (8th Cir. 1984). Cease and desist authority was added to the sanctions available to the Commission in administrative proceedings by the Remedies Act of 1990. As noted in the House Report on the legislation, other federal agencies, e.g., the Commodity Futures Trading Commission (CFTC), Federal Trade Commission (FTC), National Labor Relations Board (NLRB), and each of the federal bank regulatory agencies were empowered to issue cease and desist orders; a cease and desist order was described as an administrative remedy comparable to an injunction. (H. Rep. 101-616, at 23-24.) A likelihood of future violation is required for an injunction. SEC v. Steadman, 967 F.2d 636, 647-48 (D.C. Cir. 1992); United States v. W.T. Grant Co., 345 U.S. 629, 633 (1953).

The Steadman court sumamarized the law in this area as follows:

> "'The ultimate test'" of whether an injunction should issue "'is whether the defendant's past conduct indicates . . . that there is a reasonable likelihood of further violation[s] in the future.'" There must be "some cognizable danger of recurrent violation, something more than the mere possibility which serves to keep the case alive." The relevant factors we consider when assessing the likelihood of recurrent violation include "whether a defendant's violation was isolated or part of a pattern, whether the violation was flagrant and deliberate or merely technical in nature, and whether the defendant's business will present opportunities to violate the law in the future." Injunctive relief is reserved for willful lawbreakers or those whose operations are so extremely or persistently sloppy as to post a continuing danger to the investing public.
>
> . . . A permanent injunction is "'a drastic remedy' and should not be granted lightly, especially when the conduct has ceased."

SEC v. Steadman, 967 F.2d at 647-48 (citations omitted) (quoting SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1168 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979: W.T. Grant Co., 345 U.S. at 633; SEC v. First City Fin. Corp., 890 F.2d 1215, 1228 (D.C. Cir. 1989); 1 T. HAZEN, THE LAW OF SECURITIES REGULATION § 9.5, at 400 (2d ed. 1990.)).

The Respondents' violations were isolated, and their use of performance materials was discontinued after the 1991 Chart and 1991 Bar Graph were used in presentations to prospective clients in 1992. The violations were closer to "merely technical" on a continuum between "merely technical" and "flagrant and deliberate." Finally, the censure is a deterrent against future violations. Therefore, while the Respondents remain in the investment adviser business, so their business will present opportunities to violate the law in the future, the censure reduces the likelihood of future violations.

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b) (1996), I certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on July 19, 1996.

VI. ORDER

I ORDER that the Division's motions to exclude the testimony of Dr. Lessard and Mr. Piccione ARE DENIED and that Dr. Lessard and Mr. Piccione ARE ACCEPTED as experts in standards and practices in the investment advisory industry.

Based on the findings and conclusions set forth above:

I FURTHER ORDER that, pursuant to Section 203(e) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-3(e), Valicenti Advisory Services, Inc., IS CENSURED for violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder; and

I FURTHER ORDER that this administrative proceeding IS DISMISSED as to Respondent Vincent R. Valicenti.

This order shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360 (1996). Pursuant to that rule, a petition for review of this initial decision may be filed within 21 days after service of the decision. It shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 360(d)(1) within 21 days after service of the initial decision upon that party, unless the Commission, pursuant to Rule 360(b)(1), determines on its own initiative to review this initial decision as to any party. If a party timely files a petition for review, or the Commission acts to review as to a party, the initial decision shall not become final as to that party.

s/ Carol Fox Foelak
Carol Fox Foelak
Administrative Law Judge

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

40 Foley Square

New York, NY 10007

At a stated Term of the united States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York on the 24th day of February Two Thousand

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Valicenti Advisory Services, Inc & Vincent R Valicenti,

Petitioners,

v.

Securities and Exchange Commission,

Respondent.

99-4022

Stamp: UNITED STATES COURT OF APPEALS FILED FEB 24 2000 KAREN GREVE MILTON, ACTING CLERK SECOND CIRCUIT

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the Petitioners Valicenti Advisory Services, Inc. and Vincent R. Valicenti

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be take thereon.

FOR THE COURT:
ROSEANN B. MACKECHNIE, Clerk
by:
s\ Beth J. Meador
Beth J. Meador
Administrative Attorney